

BUY

TP: Rs 510 | ▲ 17%

LAURUS LABS

Pharmaceuticals

31 January 2020

Another good beat – TP raised to Rs 510

Laurus Labs reported a consecutive beat with best-ever Q3 EBITDA, led by strong operating leverage in formulations and higher gross margins. Weakness in ARVs and Onco API was a key negative. EBITDA stood at Rs 1.5bn with 20.3% margins. PAT was at Rs 736mn due to low tax. Laurus expects to sustain the momentum in coming quarters. New formulation capacity by Apr-Jun'20 should drive 20% growth in FY21. Improving return ratios and positive FCF are focus areas. We raise FY21/FY22 EBITDA 3-5% and our TP 6% to Rs 510.

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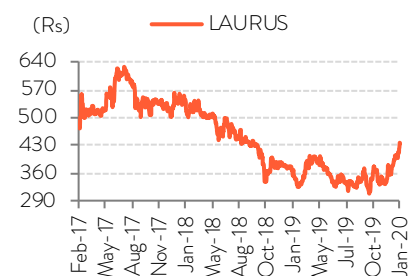
Best-ever EBITDA and margin beat look sustainable: Sequentially, the quarter saw a strong sales pickup in high-margin business (ex-ARV) from 51% to 68% share. Formulation sales came in at US\$ 40mn vs. estimates of US\$ 25mn. Other API segment grew 99% YoY (14% QoQ) led by CVS, driving gross margins of 50.6% (11-quarter high) and EBITDA margins of 20.3% (+380bps YoY, 96bps QoQ). The margin beat could sustain led by a good LMIC order book, TLE400/600mg and TEE approvals in H1FY21. Management is bullish on the non-Aspen CDMO business and expects >20% growth in FY20-FY23.

Ticker/Price	LAURUS IN/Rs 436
Market cap	US\$ 648.7mn
Shares o/s	106mn
3M ADV	US\$ 0.8mn
52wk high/low	Rs 443/Rs 303
Promoter/FPI/DII	33%/9%/39%

Source: NSE

Solid execution on formulations: Formulations clocked >25% EBITDA margins for 9MFY20 (assuming 50% gross margin and US\$ 20mn opex as per management). Laurus has raised the FY20 sales target from US\$ 70mn to US\$ 120mn and expects 20% growth in FY21 as debottlenecked capacity will be available by Apr-Jun'20, leading to upward revision in our estimates.

STOCK PERFORMANCE



Source: NSE

Earnings call highlights: (1) RM price disruption from the coronavirus outbreak not visible as of now but can have an impact if operational shutdown continues beyond March. (2) ARV sales to recover in FY21 – Q3 weakness due to delay in supplementary tender. (3) 9M capex at Rs 1.4bn (vs. Rs 2.5bn guided for FY21).

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	20,562	22,919	27,500	31,873	35,731
EBITDA (Rs mn)	4,134	3,560	5,080	6,531	7,617
Adj. net profit (Rs mn)	1,483	937	1,650	2,663	3,266
Adj. EPS (Rs)	13.9	8.8	15.5	25.0	30.7
Adj. EPS growth (%)	(10.8)	(36.8)	76.0	61.4	22.6
Adj. ROAE (%)	10.5	6.2	10.1	14.6	15.5
Adj. P/E (x)	31.3	49.5	28.1	17.4	14.2
EV/EBITDA (x)	13.6	15.8	11.2	8.8	7.5

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	Q3FY20E	Var. (%)	9MFY20	9MFY19	YoY (%)
Net Sales	7,295	5,294	37.8	7,124	2.4	6,803	7.2	19,925	16,566	20.3
EBITDA	1,483	877	69.1	1,379	7.5	1,352	9.6	3,695	2,441	51.4
Depreciation	476	427	-	478	-	470	-	1,412	1,207	-
EBIT	1,007	450	-	901	-	882	-	2,283	1,234	-
Interest	208	236	-	256	-	238	-	689	705	-
Other Income	19	14	-	14	-	10	-	78	145	-
PBT	818	228	258.9	659	24.1	655	24.9	1,671	674	148.0
Less: Taxation	82	50	-	92	-	170	-	217	166	-
Less: Minority Interest	0	0	-	0	-	0	-	0	0	-
Recurring PAT	736	178	312.3	567	29.7	485	51.8	1,454	508	186.5
Exceptional items	0	0	-	0	-	0	-	-	-	-
Reported PAT	736	178	312.3	567	29.7	485	51.8	1,454	508	186.5
Key Ratios (%)										
Gross Margin	50.6	46.4	-	49.5	-	50.0	-	50.6	50.6	-
EBITDA Margin	20.3	16.6	-	19.4	-	19.9	-	18.5	14.7	-
Tax / PBT	10.1	21.7	-	14.0	-	26.0	-	13.0	24.7	-
NPM	10.1	3.4	-	8.0	-	7.1	-	7.3	3.1	-
EPS (Rs)	6.9	1.7	-	5.3	-	4.6	-	13.7	4.8	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	Q3FY20E	Var. (%)	9MFY20	9MFY19	YoY (%)
Generics – API	3,578	4,457	(19.7)	4,624	(22.6)	4,000	(10.6)	11,899	14,263	(16.6)
ARVs	1,980	3,202	(38.2)	2,986	(33.7)	2,700	(26.7)	7,684	10,803	(28.9)
Hep C	155	197	(21.3)	183	(15.3)	150	3.3	450	757	(40.5)
Oncology	468	569	(17.8)	597	(21.6)	500	(6.4)	1,515	1,465	3.4
Other API	975	489	99.4	858	13.6	650	50.0	2,250	1,238	81.8
Synthesis	617	541	14.0	603	2.3	703	(12.3)	1,810	1,610	12.4
Ingredients	179	106	68.9	298	(39.9)	350	(48.9)	636	429	48.4
Formulations	2,921	191	1429.3	1,599	82.7	1,750	66.9	5,580	267	1,990.7
Net Sales	7,295	5,295	37.8	7,124	2.4	6,803	7.2	19,925	16,568	20.3

Source: Company, BOBCAPS Research

Valuation methodology

We retain our 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 which could re-rate the stock in coming years. In the next two years, these high-margin segments would drive >80% of incremental EBITDA and ROCE of >16% 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.

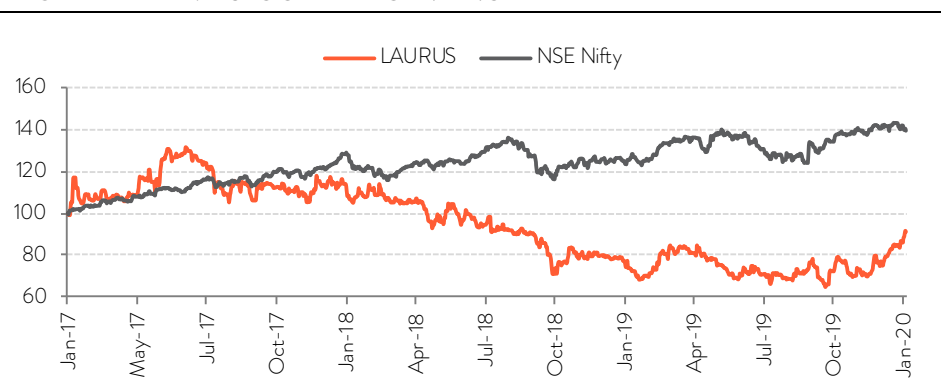
Laurus has rallied 30% over the last two months but still trades near historical lows, at 8.8x FY21E EV/EBITDA. Our target EV/EBITDA multiple of 9x FY21E is in line with peers but at a 40% discount to Divi's Labs. Based on 9MFY20 numbers and strong performance of the formulations business, we raise our FY21/FY22 EBITDA forecasts by 5%/3%. We also roll forward valuations to Mar'22 EBITDA, leading to a revised Mar'21 target price of Rs 510 (from Rs 480). Maintain BUY.

FIG 3 – REVISED ESTIMATES

(Rs bn)	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Sales	27.5	31.9	35.7	25.9	29.4	32.7	6.0	8.3	9.3
EBITDA	5.1	6.5	7.6	4.6	6.2	7.4	10.0	5.0	3.1
EBITDA margin (%)	18.5	20.5	21.3	17.8	21.1	22.6	66bps	(65bps)	(128bps)
EPS (Rs)	16	25	31	12	23	29	24.7	8.7	4.6

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	27,500	31,873	35,731
EBITDA	4,134	3,560	5,080	6,531	7,617
Depreciation	1,254	1,642	1,879	2,067	2,358
EBIT	2,880	1,918	3,201	4,464	5,259
Net interest income/(expenses)	(796)	(882)	(974)	(977)	(973)
Other income/(expenses)	98	161	34	63	68
Exceptional items	0	0	0	0	0
EBT	2,182	1,197	2,260	3,551	4,355
Income taxes	698	260	610	888	1,089
Extraordinary items	194	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	1,678	937	1,650	2,663	3,266
Adjustments	194	0	0	0	0
Adjusted net profit	1,483	937	1,650	2,663	3,266

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	3,123	4,882	4,520	4,803	5,384
Other current liabilities	1,488	1,411	1,925	2,231	2,501
Provisions	253	365	438	508	569
Debt funds	10,477	11,068	11,860	11,117	11,772
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	15,983	18,446	21,513
Shareholders' fund	14,824	15,581	17,047	19,511	22,577
Total liabilities and equities	30,165	33,307	35,791	38,169	42,803
Cash and cash eq.	31	30	578	613	687
Accounts receivables	5,705	7,099	7,157	8,296	9,300
Inventories	5,847	6,819	7,383	7,859	8,810
Other current assets	2,108	1,939	3,025	3,506	3,930
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
Total assets	30,165	33,307	35,791	38,169	42,803

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	2,932	2,579	3,529	4,730	5,624
Interest expenses	0	0	1	1	0
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(205)	(402)	(1,484)	(1,437)	(1,467)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	2,727	2,177	2,046	3,294	4,157
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
Cash flow from investing	(3,753)	(3,117)	(2,105)	(2,316)	(4,538)
Equities issued/Others	2	4	0	0	0
Debt raised/repaid	1,385	591	792	(743)	655
Interest expenses	0	0	(1)	(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	608	(944)	455
Changes in cash and cash eq.	(10)	(1)	549	34	74
Closing cash and cash eq.	31	29	578	613	687

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	15.8	8.8	15.5	25.0	30.7
Adjusted EPS	13.9	8.8	15.5	25.0	30.7
Dividend per share	1.5	1.5	1.5	1.5	1.5
Book value per share	139.3	146.4	160.2	183.3	212.1

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.7	2.4	2.1	1.8	1.6
EV/EBITDA	13.6	15.8	11.2	8.8	7.5
Adjusted P/E	31.3	49.5	28.1	17.4	14.2
P/BV	3.1	3.0	2.7	2.4	2.1

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	70.6	79.5	82.8
EBIT margin (EBIT/Revenue)	14.0	8.4	11.6	14.0	14.7
Asset turnover (Revenue/Avg TA)	21.6	22.1	24.7	26.8	27.5
Leverage (Avg TA/Avg Equity)	1.7	1.7	1.7	1.6	1.5
Adjusted ROAE	10.5	6.2	10.1	14.6	15.5

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	20.0	15.9	12.1
EBITDA	1.4	(13.9)	42.7	28.6	16.6
Adjusted EPS	(10.8)	(36.8)	76.0	61.4	22.6
Profitability & Return ratios (%)					
EBITDA margin	20.1	15.5	18.5	20.5	21.3
EBIT margin	14.0	8.4	11.6	14.0	14.7
Adjusted profit margin	7.2	4.1	6.0	8.4	9.1
Adjusted ROAE	10.5	6.2	10.1	14.6	15.5
ROCE	12.5	8.0	11.6	15.2	16.4
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	1.2	1.3	1.2
Current ratio	2.8	2.4	2.6	2.7	2.7
Net interest coverage ratio	3.6	2.2	3.3	4.6	5.4
Adjusted debt/equity	0.7	0.7	0.7	0.5	0.5

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

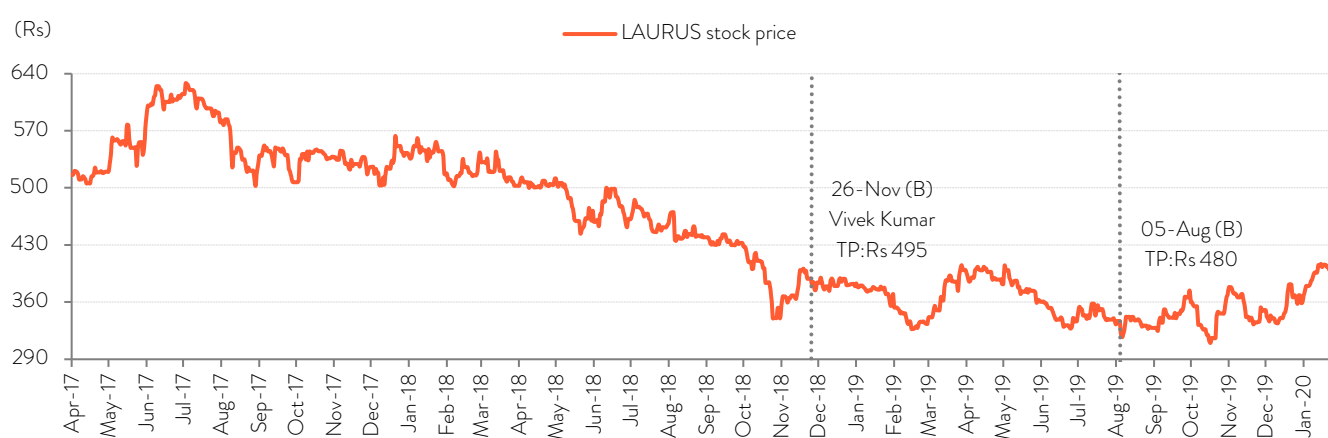
ADD – Expected return from >+5% to +15%

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)

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



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

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