

HOLD

TP: Rs 570 | ▲ 14%

LAURUS LABS

| Pharmaceuticals

| 29 January 2022

PAT declines 44% on negative operating leverage

- Inventory destocking in ARV API/FDF led to 20% YoY decline in revenue; guided to normalise from Q4
- Growth momentum continues in CDMO and non-ARV business. Management expects 30% EBITDA margin from FY22 onwards
- We cut FY22-FY24 EBITDA 26-27% and downgrade the stock from BUY to HOLD; on rollover, we have a revised TP of Rs 570 (vs. Rs 715)

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Revenue affected by channel destocking of ARV drugs: Laurus reported a 20% YoY drop in Q3FY22 revenue because of lower sales of ARV APIs and formulations (60% of revenue). ARV APIs declined 64% YoY while generic FDF fell 13% YoY. Management expects the sharper-than-expected slowdown to be transient and to normalise from Q4FY22.

Momentum in custom synthesis; strong growth in non-ARV APIs: Laurus's continued focus on non-ARV APIs and CDMO synthesis is paying off, with higher contribution and growth of 63% YoY in CDMO, 37% in other APIs and 33% in oncology APIs. Expansion of CDMO capability is on track and the company has a strong outlook for the business.

Negative operating leverage squeezes EBITDA: Gross margin for the quarter improved by 400bps YoY and 300bps QoQ to 58.8% due to a better product mix. A lack of operating leverage caused EBITDA margin to contract 540bps YoY and 100bps QoQ to 27.7%. With ongoing brownfield and greenfield capacity expansion, 25% of gross block remains non-operational which increases operating costs without revenue contribution. Global inflation in APIs and solvents also affected gross margin in Q3. Management is, however, optimistic of maintaining 30% EBITDA margins in FY22 and beyond.

Downgrade to HOLD, TP reduced to Rs 570: Given high industry-wide channel inventory and slower demand for ARV formulations and APIs, we cut our FY22-FY24 EBITDA estimates by 26-27% and downgrade the stock to HOLD from BUY. On rollover, we have a revised TP of Rs 570 (from Rs 715) based on 17x FY24E EV/EBITDA. Laurus is investing Rs 15bn-17bn over the next two years to expand capacity in the CDMO/non-ARV business. While we are positive on prospects of the non-ARV portfolio, the benefits are likely to be back-ended. In the interim, we expect a fall in return ratios and asset-turnover ratios.

Key changes

Target	Rating
▼	▼

Ticker/Price	LAURUS IN/Rs 500
Market cap	US\$ 3.6bn
Free float	74%
3M ADV	US\$ 19.7mn
52wk high/low	Rs 724/Rs 333
Promoter/FPI/DII	27%/23%/5%

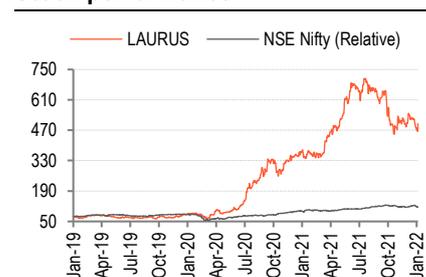
Source: NSE | Price as of 28 Jan 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	48,135	46,690	54,392
EBITDA (Rs mn)	15,331	13,540	15,774
Adj. net profit (Rs mn)	9,660	7,771	9,000
Adj. EPS (Rs)	18.0	14.5	16.8
Consensus EPS (Rs)	18.0	19.1	25.2
Adj. ROAE (%)	44.2	26.5	24.5
Adj. P/E (x)	27.8	34.5	29.8
EV/EBITDA (x)	18.2	20.8	17.9
Adj. EPS growth (%)	276.6	(19.6)	15.8

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21
Net Sales	10,288	12,884	(20.2)	12,035	(14.5)	35,107	34,015
EBITDA	2,853	4,263	(33.1)	3,451	(17.3)	10,257	10,785
Depreciation	640	516	-	632	-	1,858	1,514
EBIT	2,213	3,747	-	2,819	-	8,400	9,271
Interest	231	174	-	221	-	718	463
Other Income	53	69	-	28	-	140	191
PBT	2,035	3,642	(44.1)	2,626	(22.5)	7,821	8,999
Less: Taxation	485	913	-	586	-	1,816	2,130
Less: Minority Interest	12	0	-	0	-	12	0
Recurring PAT	1,538	2,729	(43.6)	2,040	(24.6)	5,993	6,869
Exceptional items	0	0	-	0	-	0	0
Reported PAT	1,538	2,729	(43.6)	2,040	(24.6)	5,993	6,869
Key Ratios (%)							
Gross Margin	58.8	54.7	404	55.7	304	57.0	55.0
EBITDA Margin	27.7	33.1	(536)	28.7	(94)	29.2	31.7
Tax / PBT	23.8	25.1	-	22.3	-	23.2	23.7
NPM	14.9	21.2	-	16.9	-	17.1	20.2
EPS (Rs)	2.86	5.1	(43.7)	3.8	-	11.2	12.8

Source: Company, BOBCAPS Research

Fig 2 – Segmental performance

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Generics – API	4,240	7,310	(42.0)	5,270	(19.5)	15,000	18,240	(17.8)
ARVs	2,035	5,680	(64.2)	3,373	(39.7)	9,526	12,830	(25.8)
Oncology	848	640	32.5	738	14.9	2,190	2,010	8.9
Other API	1,357	990	37.1	1,159	17.0	3,285	3,400	(3.4)
Synthesis	2,070	1,270	63.0	1,550	33.5	5,570	3,430	62.4
Formulations	3,730	4,300	(13.3)	4,950	(24.6)	13,890	12,340	12.6
Bio	250	-	-	260	(3.8)	650	-	-
Net Sales	10,290	12,880	(20.1)	12,030	(14.5)	35,110	34,010	3.2

Source: Company, BOBCAPS Research

Earnings call highlights

- **Revenue:** The disadvantage of a higher base effect and destocking at channel partners affected ARV API and formulation sales in Q3FY22. Management expects improvement in Q4 onwards. CDMO business showed strong momentum while the non-ARV API business saw a healthy rebound.
- **Margins:** A better product mix (with higher revenue contribution of CDMO and non-ARV) improved gross margin, but negative operating leverage affected EBITDA margin. Management has guided for a 30% EBITDA margin in FY22 and beyond.
- **Guidance:** Management is targeting US\$ 1bn in revenue by FY23. To this end, Laurus will focus on European and North American markets in the diabetes and cardiovascular therapy areas for both APIs and FDFs. Achieving its target is contingent upon timely capacity addition, approvals and orders from existing as well as new customers.
- **CDMO business:** Anticipating sharp growth in the CDMO business on the back of multi-year contracts, the company aims to achieve 25% contribution from this segment (including the biologics business).
- **Capex:** Laurus incurred capex of Rs 7bn in 9MFY22. It plans to invest a further Rs 15bn-17bn over FY23-FY24.
- **Capacity:** FDF brownfield expansion is nearing completion and is expected to be operational in H1FY23. Management expects full utilisation of the 10bn tablet capacity by Q1FY24. In the bio division, the remaining two fermenters have been commissioned, taking the total operational capacity to 180KL as on Dec'21. Benefits of the full operational capacity will reflect from Q4 onwards. The company is acquiring an additional land parcel to build 1mn litres of fermentation capacity.
- **Product filings:** Laurus filed one product dossier in developed markets in Q3, taking its total filings to eight for 9MFY22. It has cumulatively filed 30 ANDAs in the US with 14 Para-IV filings and 10 FTF opportunities. To date, it has filed 71 DMFs.
- **Debt:** Currently, the company has gross debt of Rs 17.5bn and plans to reduce this from FY23 onwards.

Valuation methodology

Given the industry-wide channel inventory buildup and slower demand for ARV formulations and APIs, we cut our FY22-FY24 EBITDA estimates by 26-27% and downgrade the stock to HOLD from BUY. On rollover, we have a revised TP of Rs 570 (from Rs 715) based on 17x FY24E EV/EBITDA.

Laurus is striving to grow its non-ARV business with heavy investments of Rs 15bn-17bn planned for FY23-FY24 toward expanding existing capacity and adding two greenfield projects. The key to success will be timely implementation and faster ramp-up of these capacities. Given general operational issues, it typically takes 2-3 years for utilisation of new capacities to rise above 60%. Hence, while we are positive on the prospects of the non-ARV portfolio, we expect the benefits to be back-ended. In the interim, we expect a fall in return ratios and asset-turnover ratios. EBITDA margin will also be impacted once the contribution from ARV products increases.

Fig 3 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Sales	46.7	54.4	62.7	58.6	68.3	81.7	(20.3)	(20.4)	(23.2)
EBITDA	13.5	15.8	18.8	18.2	21.3	25.6	(25.7)	(26.0)	(26.6)
EBITDA margin (%)	29.0	29.0	30.0	31.1	31.2	31.4	(211bps)	(219bps)	(137bps)
EPS (Rs)	14.5	16.8	20.2	22.1	25.8	32.0	(34.5)	(35.1)	(36.7)

Source: BOBCAPS Research

Fig 4 – Key assumptions

Parameter (Rs bn)	FY21	FY22E	FY23E	FY24E
Generics – API	26.7	19.9	21.8	23.8
Synthesis	16.6	18.0	21.9	26.3
Formulations	5.2	7.8	9.3	11.0
Bio	0.0	1.0	1.3	1.6

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY21-24E (%)	ROE (%)		ROIC (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Divi's Lab	DIVI IN	HOLD	5,540	17.6	25.9	26.2	42.4	45.6	31
Laurus Lab	LAURUS IN	HOLD	570	6.7	24.3	23.6	29.3	32.7	17

Source: BOBCAPS Research

Key risks

- **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	2.5	2,178	2,800	BUY
Alembic Pharma	ALPM IN	2.0	746	980	BUY
Alkem Labs	ALKEM IN	5.4	3,417	4,250	HOLD
Aurobindo Pharma	ARBP IN	4.9	624	886	BUY
Cipla	CIPLA IN	10.0	932	1,160	BUY
Divi's Labs	DIVI IN	13.9	3,941	5,540	HOLD
Dr Reddy's Labs	DRRD IN	9.3	4,219	5,500	BUY
Eris Lifesciences	ERIS IN	1.3	696	975	BUY
Laurus Labs	LAURUS IN	3.6	500	570	HOLD
Lupin	LPC IN	5.4	900	1,045	HOLD
Sun Pharma	SUNP IN	26.4	827	955	BUY

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

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	28,317	48,135	46,690	54,392	62,748
EBITDA	5,658	15,331	13,540	15,774	18,824
Depreciation	1,873	2,051	2,392	2,917	3,538
EBIT	3,785	13,280	11,148	12,856	15,286
Net interest inc./(exp.)	(896)	(682)	(976)	(1,007)	(941)
Other inc./(exp.)	59	237	189	151	136
Exceptional items	0	0	0	0	0
EBT	2,948	12,835	10,361	12,000	14,482
Income taxes	383	3,173	2,590	3,000	3,620
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	2	0	0	0
Reported net profit	2,565	9,660	7,771	9,000	10,861
Adjustments	0	0	0	0	0
Adjusted net profit	2,565	9,660	7,771	9,000	10,861

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	6,156	11,787	9,594	11,176	12,034
Other current liabilities	1,625	3,158	3,268	3,264	4,392
Provisions	568	757	734	855	986
Debt funds	11,456	15,799	14,233	10,949	9,953
Other liabilities	0	0	0	0	0
Equity capital	1,069	1,073	1,073	1,073	1,073
Reserves & surplus	16,623	24,934	31,667	39,661	49,516
Shareholders' fund	17,692	26,007	32,740	40,734	50,589
Total liab. and equities	37,497	57,507	60,569	66,978	77,955
Cash and cash eq.	17	485	903	(2,131)	2,871
Accounts receivables	7,914	13,061	12,152	14,753	17,019
Inventories	9,052	15,754	14,710	17,584	20,286
Other current assets	2,545	2,845	2,334	2,720	3,765
Investments	34	34	34	34	34
Net fixed assets	17,068	19,150	24,258	28,840	28,802
CWIP	672	3,622	3,622	2,622	2,622
Intangible assets	195	2,556	2,556	2,556	2,556
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	37,497	57,507	60,569	66,978	77,955

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	2,474	6,914	10,521	7,757	10,504
Capital expenditures	(2,374)	(7,000)	(7,500)	(7,500)	(3,500)
Change in investments	0	0	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(2,374)	(7,000)	(7,500)	(7,500)	(3,500)
Equities issued/Others	5	4	0	0	0
Debt raised/repaid	388	4,343	(1,566)	(3,285)	(995)
Interest expenses	0	0	0	0	0
Dividends paid	0	(1,006)	(1,006)	(1,006)	(1,006)
Other financing cash flows	(506)	(2,787)	(31)	1,000	0
Cash flow from financing	(113)	554	(2,603)	(3,291)	(2,001)
Chg in cash & cash eq.	(13)	468	418	(3,034)	5,003
Closing cash & cash eq.	17	485	903	(2,131)	2,871

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	4.8	18.0	14.5	16.8	20.2
Adjusted EPS	4.8	18.0	14.5	16.8	20.2
Dividend per share	1.5	1.5	1.5	1.5	1.5
Book value per share	33.0	48.4	61.0	75.9	94.3

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	9.9	5.8	6.0	5.2	4.5
EV/EBITDA	49.3	18.2	20.8	17.9	14.9
Adjusted P/E	104.6	27.8	34.5	29.8	24.7
P/BV	15.2	10.3	8.2	6.6	5.3

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	87.0	75.3	75.0	75.0	75.0
Interest burden (PBT/EBIT)	77.9	96.6	92.9	93.3	94.7
EBIT margin (EBIT/Revenue)	13.4	27.6	23.9	23.6	24.4
Asset turnover (Rev./Avg TA)	25.4	33.9	26.3	27.6	28.0
Leverage (Avg TA/Avg Equity)	1.7	1.6	1.5	1.3	1.2
Adjusted ROAE	15.4	44.2	26.5	24.5	23.8

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	23.6	70.0	(3.0)	16.5	15.4
EBITDA	58.1	171.0	(11.7)	16.5	19.3
Adjusted EPS	168.0	276.6	(19.6)	15.8	20.7
Profitability & Return ratios (%)					
EBITDA margin	20.0	31.9	29.0	29.0	30.0
EBIT margin	13.4	27.6	23.9	23.6	24.4
Adjusted profit margin	9.1	20.1	16.6	16.5	17.3
Adjusted ROAE	15.4	44.2	26.5	24.5	23.8
ROCE	13.8	38.1	25.5	26.4	27.5
Working capital days (days)					
Receivables	102	99	95	99	99
Inventory	117	119	115	118	118
Payables	79	89	75	75	70
Ratios (x)					
Gross asset turnover	1.2	1.6	1.2	1.2	1.3
Current ratio	2.3	2.0	2.2	2.2	2.5
Net interest coverage ratio	4.2	19.5	11.4	12.8	16.3
Adjusted debt/equity	0.6	0.6	0.4	0.3	0.1

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

Disclaimer

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

BUY – Expected return >+15%

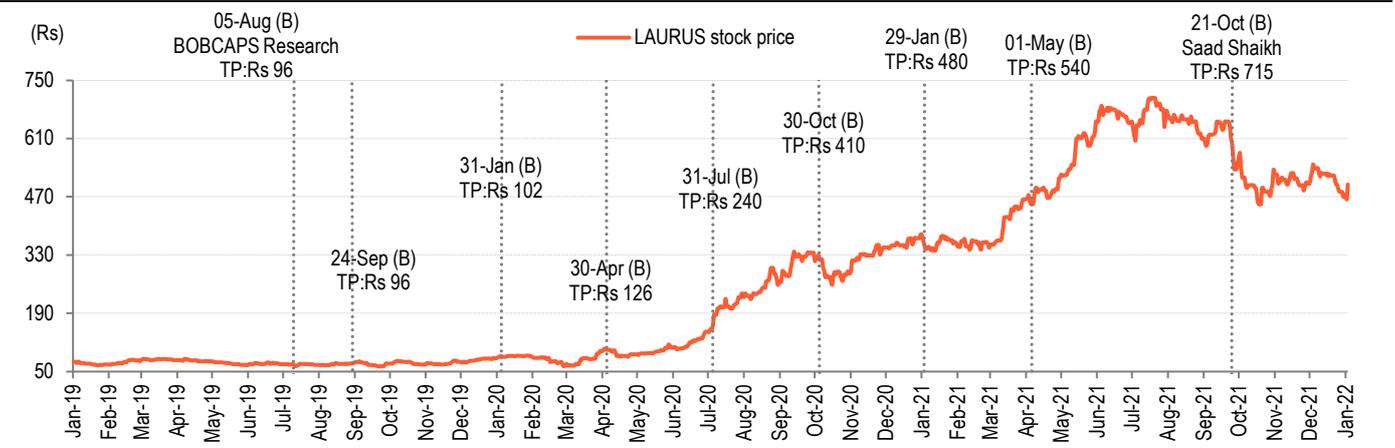
HOLD – Expected return from -6% to +15%

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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