

BUY

TP: Rs 1,200 | ▲ 29%

LAURUS LABS

Pharmaceuticals

31 July 2020

All-round beat; multiple positives spur big upgrade – TP Rs 1,200

Laurus Labs reported a record Q1 beat with no major one-offs. Revenue/EBITDA surpassed estimates by 18%/59%. EBITDA grew 234% YoY/45% QoQ with margins at 28.6% (21.2% est.) aided by product mix, operating leverage and forex. PAT doubled our estimates. ARV sales grew 19% YoY, other API 47% QoQ, synthesis 37% YoY and formulations 32% QoQ. High order book visibility implies stronger growth and ROCE expansion. Q1 positives usher in a new normal, driving >80% EPS upgrade; TP raised to Rs 1,200 (12x Sep'22E EV/EBITDA) vs. Rs 630.

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Big EPS upgrade – Laurus our top pick: Laurus's Q1 result has multiple positives on the core business that are emerging as the new normal – (1) start of structural volume uptrend in ARV portfolio, (2) strong uptick in order book across high-margin segments of formulations, synthesis (non-Aspen CDMO) and non-ARV APIs, led by global supply chain disruption, and (3) shift in GPM from 47-50% to 52-53%. Management expects most of these positives to sustain in coming years. This combined with 33% savings in annual interest cost drives our >80% FY22 EPS upgrade. With the execution track record gaining scale, Laurus remains our top midcap pick as we see further upside risk on EPS.

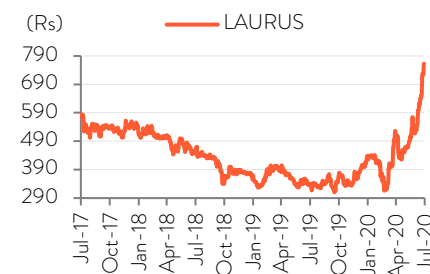
Adj. EBITDA margin and incremental GP/Sales solid QoQ: A large part of the operating margin beat was led by higher gross margins. On incremental sales QoQ, gross margin was at 80% (>80% from product mix and operating leverage across segments). Excluding one-time HCQS sales of US\$ 5mn @ 30% margin and ~2ppt forex benefit, adj. EBITDA margin was strong at +25%.

Earnings call highlights: (1) Q1 has no price increase benefit. (2) Capacity rise in formulations/non-ARV APIs on track (phase-1/2 by Sep'20/Dec'21). (3) TLE 400/600 launch in Q2. (4) On track to improve ARV sales, led by Efavirenz, Tenofovir, DTG, Lamivudine in FY21 and second-line ARV products in FY22.

Ticker/Price	LAURUS IN/Rs 933
Market cap	US\$ 1.3bn
Shares o/s	106mn
3M ADV	US\$ 14.3mn
52wk high/low	Rs 945/Rs 295
Promoter/FPI/DII	32%/37%/5%

Source: NSE

STOCK PERFORMANCE



KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	22,919	28,317	35,791	40,610	45,117
EBITDA (Rs mn)	3,560	5,645	9,249	11,066	12,620
Adj. net profit (Rs mn)	937	2,553	5,339	6,760	7,982
Adj. EPS (Rs)	8.8	24.0	50.2	63.5	75.0
Adj. EPS growth (%)	(36.8)	172.3	109.2	26.6	18.1
Adj. ROAE (%)	6.2	15.3	26.3	25.9	24.0
Adj. P/E (x)	106.0	38.9	18.6	14.7	12.4
EV/EBITDA (x)	30.6	19.5	12.0	10.0	8.6

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)	Q1FY21E	Var. (%)	FY20	FY19	YoY (%)
Net Sales	9,743	5,506	77.0	8,390	16.1	8,264	17.9	28,315	22,917	23.6
EBITDA	2,785	833	234.3	1,917	45.3	1,752	59.0	5,612	3,560	57.6
Depreciation	488	458	-	460	-	530	-	1,872	1,641	-
EBIT	2,297	375	-	1,457	-	1,222	-	3,740	1,919	-
Interest	151	225	-	207	-	230	-	896	881	-
Other Income	71	45	-	17	-	20	-	95	161	-
PBT	2,217	194	1041.2	1,267	74.9	1,012	119.1	2,939	1,199	145.1
Less: Taxation	497	43	-	166	-	223	-	383	260	-
Less: Minority Interest	0	0	-	0	-	0	-	0	0	-
Recurring PAT	1,720	151	1036.5	1,102	56.2	789	117.9	2,556	939	172.2
Exceptional items	0	0	-	0	-	0	-	-	-	-
Reported PAT	1,720	151	1036.5	1,102	56.2	789	117.9	2,556	939	172.2
Key Ratios (%)										
Gross Margin	54.2	50.1	-	50.1	-	49.3	-	50.6	50.6	-
EBITDA Margin	28.6	15.1	-	22.8	-	21.2	-	19.8	15.5	-
Tax / PBT	22.4	22.1	-	13.1	-	22.0	-	13.0	21.7	-
NPM	17.7	2.7	-	13.1	-	9.6	-	9.0	4.1	-
EPS (Rs)	16.2	1.4	-	10.4	-	7.4	-	23.9	8.8	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)	Q1FY21E	Var. (%)	FY20	FY19	YoY (%)
Generics – API	5,220	3,717	40.4	4,239	23.1	4,485	16.4	15,680	18,018	(13.0)
ARVs	3,360	2,830	18.7	2,728	23.2	2,900	15.9	10,329	13,956	(26.0)
Oncology	510	450	13.3	591	(13.7)	585	(12.8)	2,106	2,173	(3.1)
Other API	1,350	437	208.9	920	46.7	1,000	35.0	3,245	1,889	71.8
Synthesis	1,000	729	37.2	1,479	(32.4)	875	14.3	3,850	2,550	51.0
Formulations	3,520	1,060	232.1	2,673	31.7	2,904	21.2	8,253	549	1403.6
Net Sales	9,740	5,506	76.9	8,391	16.1	8,264	17.9	27,783	21,117	31.6

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 (visible in the Q1 beat), which could re-rate the stock in coming years. Over the next two years, these high-margin segments supported by recalibration in procurement strategies of global companies are expected to drive >80% of incremental EBITDA and aid sustained ROIC of >25% from ~13% in FY20.

Given the solid order book and ahead-of-schedule execution, we won't be surprised if the company retains FY21 levels of capex in FY22. This should be taken positively as incremental capex would not be FCF-dilutive, in our view.

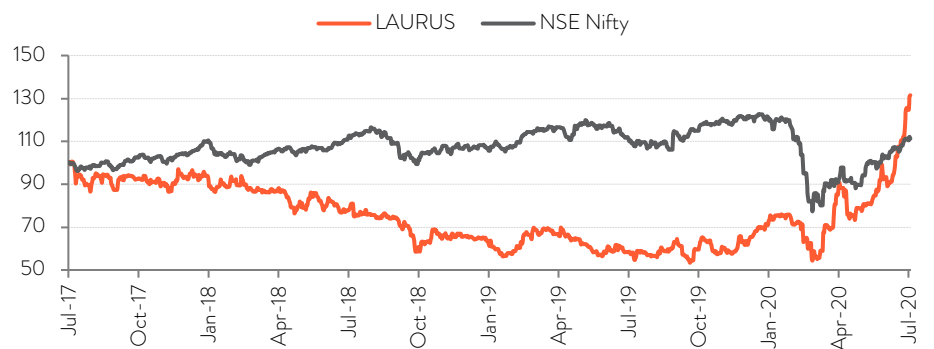
The stock has seen a fantastic run and more than doubled from Mar'20 lows to trade at 10x FY22E EBITDA currently, which is still below the three-year historical mean of 12x one-year forward. We align our one-year forward EV/EBITDA multiple to 12x (from 10x earlier) as we see further upside risk to our FY22 EPS estimate. The valuation discount to large-cap peers has reduced from 40% to 30% owing to better operational results and outlook.

We increase our FY21/FY22 EBITDA forecasts by 37-39% to factor in the solid Q1 beat, uplift in gross margins and sustainable rise in operating leverage. On rollover to Sep'22E earnings, we raise our target price to Rs 1,200 (from Rs 630). Maintain BUY.

FIG 3 – REVISED ESTIMATES

(Rs bn)	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Sales	28.3	35.8	40.6	28.3	33.0	37.4	0.1	8.5	8.6
EBITDA	5.6	9.2	11.1	5.6	6.8	8.0	0.7	36.7	38.8
EBITDA margin (%)	19.9	25.8	27.2	19.8	20.5	21.3	12bps	533bps	593bps
EPS (Rs)	24	50	64	24	28	34	(1.2)	79.1	87.8

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 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)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	22,919	28,317	35,791	40,610	45,117
EBITDA	3,560	5,645	9,249	11,066	12,620
Depreciation	1,642	1,873	1,888	2,008	2,247
EBIT	1,918	3,773	7,361	9,059	10,373
Net interest income/(expenses)	(882)	(896)	(630)	(656)	(596)
Other income/(expenses)	161	59	27	155	457
Exceptional items	0	0	0	0	0
EBT	1,197	2,936	6,758	8,557	10,233
Income taxes	260	383	1,419	1,797	2,251
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	937	2,553	5,339	6,760	7,982
Adjustments	0	0	0	0	0
Adjusted net profit	937	2,553	5,339	6,760	7,982

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	4,882	6,156	7,354	8,345	9,271
Other current liabilities	1,411	1,625	2,505	2,843	3,158
Provisions	365	568	718	814	905
Debt funds	11,068	11,456	11,456	10,415	9,468
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	21,761	28,321	36,102
Shareholders' fund	15,581	17,692	22,830	29,390	37,172
Total liabilities and equities	33,307	37,497	44,864	51,806	59,973
Cash and cash eq.	30	17	460	2,567	6,507
Accounts receivables	7,099	7,914	9,610	10,570	11,743
Inventories	6,819	9,052	11,277	13,129	14,586
Other current assets	1,939	2,545	3,937	4,467	4,963
Investments	34	34	34	34	34
Net fixed assets	16,072	17,068	18,680	20,173	21,273
CWIP	1,096	672	672	672	672
Intangible assets	218	195	195	195	195
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	33,307	37,497	44,864	51,806	59,973

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	2,579	4,425	7,227	8,768	10,229
Interest expenses	0	0	0	0	0
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(402)	(1,963)	(3,084)	(1,918)	(1,794)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	2,177	2,462	4,143	6,850	8,435
Capital expenditures	(3,117)	(2,374)	(3,500)	(3,501)	(3,347)
Change in investments	0	0	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(3,117)	(2,374)	(3,500)	(3,501)	(3,347)
Equities issued/Others	4	5	0	0	0
Debt raised/repaid	591	388	0	(1,041)	(947)
Interest expenses	0	0	0	0	0
Dividends paid	(176)	0	(200)	(200)	(200)
Other financing cash flows	519	(493)	0	0	0
Cash flow from financing	939	(100)	(200)	(1,242)	(1,147)
Changes in cash and cash eq.	(1)	(13)	443	2,107	3,941
Closing cash and cash eq.	29	17	460	2,567	6,507

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	8.8	24.0	50.2	63.5	75.0
Adjusted EPS	8.8	24.0	50.2	63.5	75.0
Dividend per share	1.5	1.5	1.5	1.5	1.5
Book value per share	146.4	166.2	214.5	276.1	349.3

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	4.8	3.9	3.1	2.7	2.4
EV/EBITDA	30.6	19.5	12.0	10.0	8.6
Adjusted P/E	106.0	38.9	18.6	14.7	12.4
P/BV	6.4	5.6	4.4	3.4	2.7

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	91.8	94.5	98.7
EBIT margin (EBIT/Revenue)	8.4	13.3	20.6	22.3	23.0
Asset turnover (Revenue/Avg TA)	22.1	25.4	28.2	27.4	26.1
Leverage (Avg TA/Avg Equity)	1.7	1.7	1.6	1.4	1.3
Adjusted ROAE	6.2	15.3	26.3	25.9	24.0

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	11.5	23.6	26.4	13.5	11.1
EBITDA	(13.9)	58.6	63.8	19.6	14.0
Adjusted EPS	(36.8)	172.3	109.2	26.6	18.1
Profitability & Return ratios (%)					
EBITDA margin	15.5	19.9	25.8	27.2	28.0
EBIT margin	8.4	13.3	20.6	22.3	23.0
Adjusted profit margin	4.1	9.0	14.9	16.6	17.7
Adjusted ROAE	6.2	15.3	26.3	25.9	24.0
ROCE	8.0	13.7	23.3	24.9	25.1
Working capital days (days)					
Receivables	113	102	98	95	95
Inventory	109	117	115	118	118
Payables	78	79	75	75	75
Ratios (x)					
Gross asset turnover	1.1	1.2	1.3	1.3	1.3
Current ratio	2.4	2.3	2.4	2.6	2.8
Net interest coverage ratio	2.2	4.2	11.7	13.8	17.4
Adjusted debt/equity	0.7	0.6	0.5	0.3	0.1

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

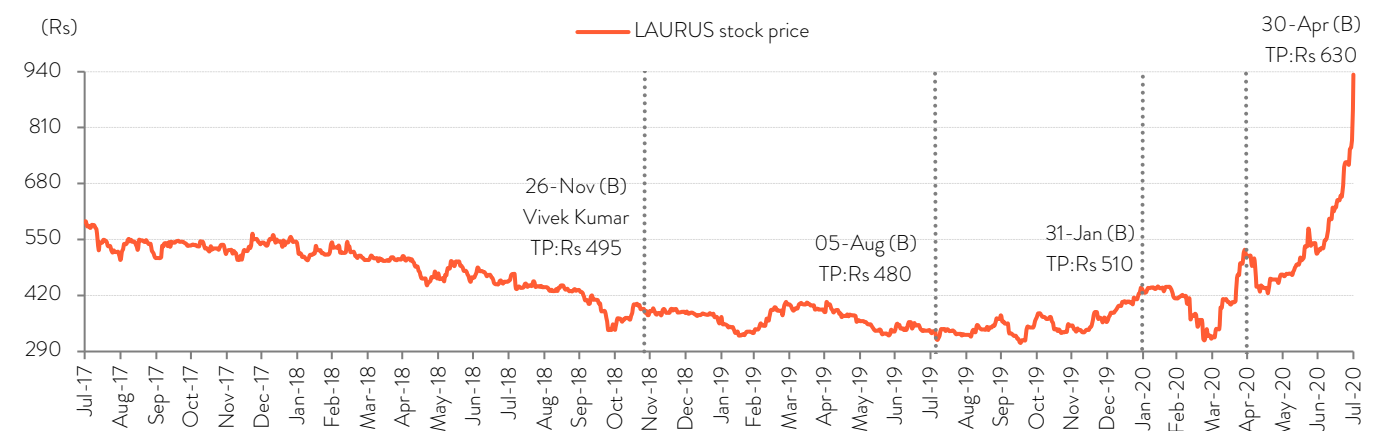
ADD – Expected return from >+5% to +15%

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)

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



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

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