

BUY

TP: Rs 645 | ▲ 23%

LAURUS LABS

| Pharmaceuticals

| 28 July 2022

Synthesis business saves the day

- Q1 revenue/EBITDA came in 5%/8% above consensus and grew 20%/15% YoY to Rs 15.4bn/Rs 4.5bn
- Stellar CDMO performance (+196% YoY) led growth while FDF declined 33% YoY; a better mix sustained margins
- Maintain BUY with a TP of Rs 645 based on an unchanged 17x FY24E EV/EBITDA multiple

Saad Shaikh

research@bobcaps.in

Synthesis business drives beat despite drop in FDF revenue: Laurus's Q1FY23 revenue grew 20%/15% YoY (+8%/15% QoQ) to Rs 15.4bn/Rs 4.5bn, spurred by steep growth of 196% YoY in the synthesis business. Contribution from synthesis rose to 37% in Q1FY23 (vs. 15% in the year-ago quarter), with growth coming from existing as well as new business. Per management, the division had no one-off revenue flows and growth momentum is guided to continue.

ARV business continues to see challenges but signs of easing: Continued challenges in ARV prices saw ARV API revenue decline 8% YoY, though sequential improvement during the last two quarters hints at some stabilisation. Moreover, the company hasn't seen much of a decline in volumes. Other APIs grew at a strong 82% YoY while moderating sequentially (-19% QoQ) on a high base.

Better mix compensates for FDF revenue drop and higher overheads: A product mix tilt towards high-margin CDMO led to an improved gross margin (+90bps YoY to 57.6%), despite a decline in formulations revenue from pricing pressure and elevated RM costs. Overhead cost rose 38.5% YoY to 18.2% of sales (vs. 15.1%/15.8% of sales in Q4FY22/Q1FY22) – the cost increase stemmed from additional expenses incurred due to power shortage (~Rs 330mn) and forex losses, in turn resulting in 140bps YoY EBITDA margin contraction to 29.5%.

Net profit for the quarter grew only 4% YoY (+9% QoQ) as recently commissioned capacities resulted in higher depreciation (+21% YoY) and a change in SEZ exemption led to a higher tax rate (29% vs. 24% in Q1FY22).

Maintain BUY, TP unchanged at Rs 645: We retain our FY23/FY24 estimates in light of (a) Laurus's strong performance in CDMO backed by growth in existing business, new contracts as well as capacity expansion, (b) expected stabilisation in ARV business, (c) commissioning of FDF capacity, and (d) confidence shown by management in achieving US\$ 1bn in sales by FY23. Our TP remains at Rs 645, based on an unchanged 17x FY24E EV/EBITDA multiple. BUY.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	LAURUS IN/Rs 525
Market cap	US\$ 3.5bn
Free float	74%
3M ADV	US\$ 9.2mn
52wk high/low	Rs 724/Rs 437
Promoter/FPI/DII	27%/23%/5%

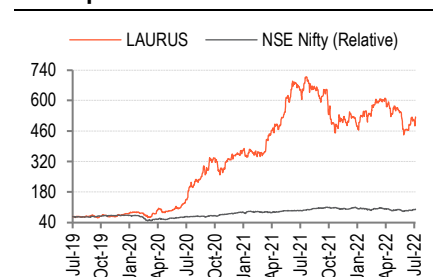
Source: NSE | Price as of 28 Jul 2022

Key financials

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	49,360	63,206	73,092
EBITDA (Rs mn)	14,229	17,698	21,197
Adj. net profit (Rs mn)	8,284	10,071	11,800
Adj. EPS (Rs)	15.4	18.8	22.0
Consensus EPS (Rs)	15.4	21.1	26.1
Adj. ROAE (%)	27.8	26.5	24.6
Adj. P/E (x)	34.0	28.0	23.9
EV/EBITDA (x)	20.7	16.9	14.3
Adj. EPS growth (%)	(14.3)	21.6	17.2

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
Net Sales	15,389	12,785	20.4	14,248	8.0	49,356	48,135	2.5
EBITDA	4,542	3,954	14.9	3,967	14.5	14,224	15,507	(8.3)
Depreciation	708	585	20.9	657	-	2,515	2,051	-
EBIT	3,834	3,368	-	3,310	-	11,709	13,456	-
Interest	293	266	-	306	-	1,024	682	-
Other Income	18	59	-	13	-	153	236	-
PBT	3,559	3,161	12.6	3,017	18.0	10,839	13,011	(16.7)
Less: Taxation	1,033	744	38.8	698	-	2,514	3,173	-
Less: Minority Interest	6	0	-	10	-	22	0	-
Recurring PAT	2,519	2,416	4.3	2,309	9.1	8,302	9,839	(15.6)
Exceptional items	0	0	-	0	-	0	0	-
Reported PAT	2,519	2,416	4.3	2,309	9.1	8,302	9,839	(15.6)
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	57.6	56.7	89	52.0	553	55.6	55.2	39
EBITDA Margin	29.5	30.9	(141)	27.8	167	28.8	32.2	(340)
Tax / PBT	29.0	23.6	-	23.1	-	23.2	24.4	-
NPM	16.4	18.9	(253)	16.2	17	16.8	20.4	(362)
EPS (Rs)	4.69	4.5	4.3	4.3	9.1	15.4	18.3	(15.7)

Source: Company, BOBCAPS Research

Fig 2 – Segmental performance

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
Generics – API	5,830	5,490	6.2	5,390	8.2	20,390	26,210	(22.2)
Antiretrovirals (ARVs)	3,790	4,118	(8.0)	2,965	27.8	12,490	18,520	(32.6)
Oncology	641	604	6.2	701	(8.5)	2,890	2,630	9.9
Other API	1,399	769	82.0	1,725	(18.9)	5,010	5,060	(1.0)
Synthesis (CDMO)	5,770	1,950	195.9	3,600	60.3	9,170	5,190	76.7
Formulations (FDF)	3,490	5,210	(33.0)	4,910	(28.9)	18,800	16,640	13.0
Bio	300	140	114.3	350	(14.3)	1,000	-	-
Net Sales	15,389	12,785	20.3	14,248	8.0	49,356	48,135	2.7

Source: Company, BOBCAPS Research

Earnings call highlights

- **Revenue:** Laurus reiterated its confidence in achieving its revenue target of US\$ 1bn in FY23 supported by new capacities in FDF and CDMO, new contracts and stabilisation in ARV prices. Currency tailwinds would be an added impetus (not factored in the guidance).
- **Margins:** Management is hopeful of a ~30% EBITDA margin for FY23 aided by an improving product mix in favour of high-margin business, additional capacities and new contracts in the synthesis business.
- **ARVs:** Total ARV contribution stood at 42% of revenue in Q1FY23, comprising 25% API and 17% formulations.
- **CDMO:** Laurus currently has seven commercial products in the CDMO business, comprising four intermediates and three APIs.
- **Laurus Bio:** Management expects business at Laurus Bio to gather pace with the ramp-up of new capacities, as the demand outlook remains strong. Full operational benefits of new capacities would reflect through FY23, and the company is evaluating land parcels to further expand manufacturing capabilities. Management expects FY25 to be a significant year for the segment.
- **Capacity expansion: (1) FDF:** Brownfield capacity expansion at Unit 2 was commissioned during the quarter, with ramp-up to be gradual. **(2) CDMO:** Construction work commenced for a dedicated R&D centre (FY23/FY24 completion) and progress on the other three manufacturing units is on track (FY24/FY25). **(3) Laurus Bio:** Laurus continues to evaluate a few land parcels with a plan to create close to 1mn litres of fermentation capacity in phase-1.
- **Capex:** The company incurred capex of Rs 2.1bn for Q1FY23 (~14% of sales) and maintained its guidance of Rs 20bn for FY23-FY24. About 50% of capex is earmarked for the CDMO business while the remaining will be utilised for non-ARV API and formulations as well as backward integration.
- **Tax rate:** Q1 had a higher effective tax rate due to the change in SEZ profit exemption u/s 10AA to 50% for a period of five years from FY23. The company is evaluating a switchover to composite rates without any exemptions.

Valuation methodology

Laurus continues to struggle due to high industry-wide channel inventory, slower demand, and pricing pressure in ARV formulations and APIs, though sequential growth during the last two quarters hints at some demand normalisation. The company is investing Rs 20bn over FY23-FY24 to expand capacity in the CDMO/non-ARV business.

We retain our FY23/FY24 estimates in light of (a) Laurus's strong performance in CDMO backed by growth in existing business, new contracts as well as capacity expansion, (b) expected stabilisation in ARV business, (c) commissioning of FDF capacity, and (d) confidence shown by management in achieving US\$ 1bn in sales by FY23. Our TP remains at Rs 645, based on an unchanged 17x FY24E EV/EBITDA multiple. Maintain BUY.

Fig 3 – Key assumptions

Revenue (Rs bn)	FY22A	FY23E	FY24E
Generic APIs	20.4	23.8	26.1
Generic FDF	18.8	21.1	25.3
Synthesis (CDMO)	9.2	17.0	20.1
Biotech	1.0	1.4	1.7

Source: Company, BOBCAPS Research

Fig 4 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY22-24E (%)	EV/EBITDA (Rs)		ROCE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Divi's Labs	DIVI IN	HOLD	5,250	4.7	25.3	23.3	27.5	25.9	26
Laurus Labs	LAURUS IN	BUY	645	21.7	16.9	14.2	27.9	28.5	17

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- **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	1.4	1,272	2,050	BUY
Alembic Pharma	ALPM IN	1.7	701	770	HOLD
Alkem Labs	ALKEM IN	4.8	3,228	3,400	BUY
Aurobindo Pharma	ARBP IN	4.0	544	680	BUY
Cipla	CIPLA IN	9.8	967	1,100	BUY
Divi's Labs	DIVI IN	12.8	3,850	4,250	HOLD
Dr Reddy's Labs	DRRD IN	8.9	4,260	4,450	HOLD
Eris Lifesciences	ERIS IN	1.2	679	970	BUY
Glenmark Life Sciences	GLS IN	0.7	467	620	BUY
Laurus Labs	LAURUS IN	3.5	525	645	BUY
Lupin	LPC IN	3.7	642	600	SELL
Sun Pharma	SUNP IN	26.9	895	1,100	BUY

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

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Total revenue	28,317	48,135	49,360	63,206	73,092
EBITDA	5,658	15,331	14,229	17,698	21,197
Depreciation	1,873	2,051	2,515	3,145	4,120
EBIT	3,785	13,280	11,714	14,553	17,077
Net interest inc./(exp.)	(896)	(682)	(1,024)	(1,246)	(1,454)
Other inc./(exp.)	59	237	153	122	110
Exceptional items	0	0	0	0	0
EBT	2,948	12,835	10,843	13,429	15,733
Income taxes	383	3,173	2,514	3,357	3,933
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	2	45	0	0
Reported net profit	2,565	9,660	8,284	10,071	11,800
Adjustments	0	0	0	0	0
Adjusted net profit	2,565	9,660	8,284	10,071	11,800

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Accounts payables	6,156	11,787	8,764	12,987	14,018
Other current liabilities	1,625	3,158	5,661	3,792	5,116
Provisions	568	757	892	1,142	1,320
Debt funds	11,456	15,799	20,774	20,774	20,774
Other liabilities	0	0	0	0	0
Equity capital	1,069	1,073	1,075	1,075	1,075
Reserves & surplus	16,623	24,934	32,516	41,604	52,423
Shareholders' fund	17,692	26,007	33,591	42,679	53,498
Total liab. and equities	37,497	57,507	69,680	81,374	94,726
Cash and cash eq.	17	485	759	336	1,787
Accounts receivables	7,914	13,061	13,542	17,143	19,825
Inventories	9,052	15,755	17,603	19,914	22,028
Other current assets	2,545	2,845	2,811	3,160	4,385
Investments	34	34	308	308	308
Net fixed assets	17,068	19,150	23,953	30,808	36,689
CWIP	672	3,622	8,132	7,132	7,132
Intangible assets	195	2,556	2,571	2,571	2,571
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	37,497	57,507	69,680	81,374	94,726

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Cash flow from operations	2,474	6,914	8,118	9,560	12,432
Capital expenditures	(2,374)	(7,000)	(9,500)	(10,000)	(10,000)
Change in investments	0	0	(274)	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(2,374)	(7,000)	(9,774)	(10,000)	(10,000)
Equities issued/Others	5	4	2	0	0
Debt raised/repaid	388	4,343	4,975	0	0
Interest expenses	0	0	0	0	0
Dividends paid	0	(1,006)	(1,008)	(1,008)	(1,008)
Other financing cash flows	(506)	(2,787)	(2,038)	1,024	27
Cash flow from financing	(113)	554	1,931	17	(981)
Chg in cash & cash eq.	(13)	468	275	(423)	1,451
Closing cash & cash eq.	17	485	759	336	1,787

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22P	FY23E	FY24E
Reported EPS	4.8	18.0	15.4	18.8	22.0
Adjusted EPS	4.8	18.0	15.4	18.8	22.0
Dividend per share	1.5	1.5	1.5	1.5	1.5
Book value per share	33.0	48.4	62.5	79.3	99.5

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22P	FY23E	FY24E
EV/Sales	10.3	6.1	6.0	4.7	4.1
EV/EBITDA	51.7	19.1	20.7	16.9	14.3
Adjusted P/E	109.9	29.2	34.0	28.0	23.9
P/BV	15.9	10.9	8.4	6.6	5.3

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22P	FY23E	FY24E
Tax burden (Net profit/PBT)	87.0	75.3	76.4	75.0	75.0
Interest burden (PBT/EBIT)	77.9	96.6	92.6	92.3	92.1
EBIT margin (EBIT/Revenue)	13.4	27.6	23.7	23.0	23.4
Asset turnover (Rev./Avg TA)	25.4	33.9	25.7	26.8	26.5
Leverage (Avg TA/Avg Equity)	1.7	1.6	1.6	1.5	1.4
Adjusted ROAE	15.4	44.2	27.8	26.5	24.6

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22P	FY23E	FY24E
YoY growth (%)					
Revenue	23.6	70.0	2.5	28.1	15.6
EBITDA	58.1	171.0	(7.2)	24.4	19.8
Adjusted EPS	168.0	276.6	(14.3)	21.6	17.2
Profitability & Return ratios (%)					
EBITDA margin	20.0	31.9	28.8	28.0	29.0
EBIT margin	13.4	27.6	23.7	23.0	23.4
Adjusted profit margin	9.1	20.1	16.8	15.9	16.1
Adjusted ROAE	15.4	44.2	27.8	26.5	24.6
ROCE	13.8	38.1	24.7	24.9	25.0
Working capital days (days)					
Receivables	102	99	100	99	99
Inventory	117	119	130	115	110
Payables	79	89	65	75	70
Ratios (x)					
Gross asset turnover	1.2	1.6	1.2	1.3	1.2
Current ratio	2.3	2.0	2.3	2.3	2.3
Net interest coverage ratio	4.2	19.5	11.4	11.7	11.7
Adjusted debt/equity	0.6	0.6	0.6	0.5	0.4

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

Disclaimer

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

BUY – Expected return >+15%

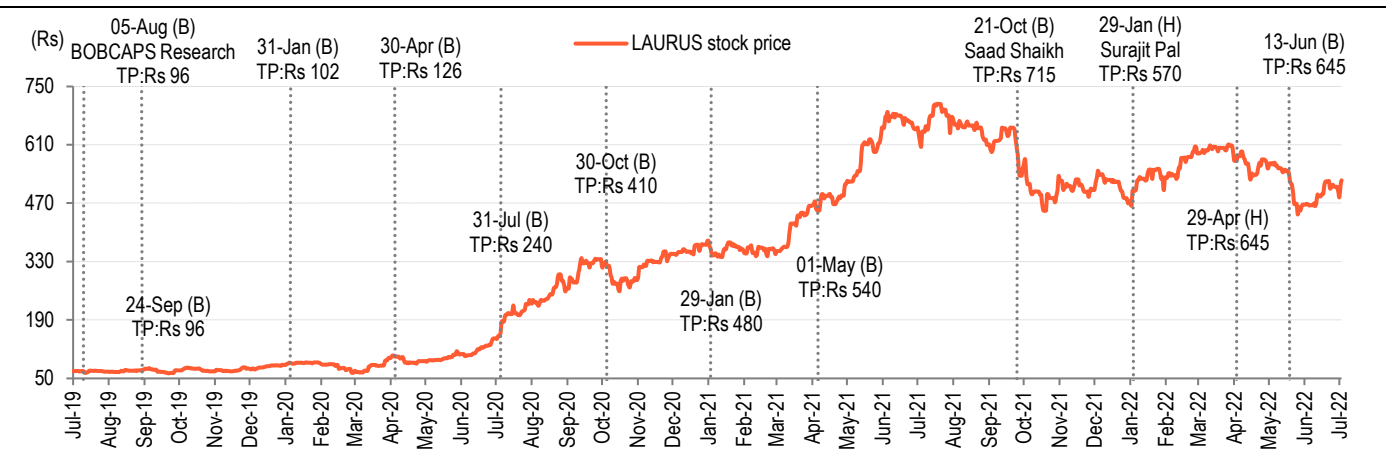
HOLD – Expected return from -6% to +15%

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

Rating distribution

As of 30 June 2022, out of 118 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 73 have BUY ratings, 23 have HOLD ratings, 5 are rated ADD*, 1 is rated REDUCE* and 16 are rated SELL. Of these, 2 companies rated BUY and 1 rated ADD have been investment banking clients in the last 12 months. (*Our ADD and REDUCE ratings are in the process of being migrated to the new recommendation structure.)

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2025. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017. BOBCAPS CIN Number: U65999MH1996GOI098009.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation

or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities — that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have “long” or “short” positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.