

HOLD

TP: Rs 540 | ▲ 11%

LAURUS LABS

| Pharmaceuticals

| 22 October 2022

CDMO scale-up masks otherwise dismal Q2; cut to HOLD

- Q2 revenue grew 31% YoY (+2% QoQ) led by synthesis division and other APIs; FDF revenue at record-low of Rs 1.5bn
- Better product mix mitigated impact of FDF revenue loss on EBITDA margin (28.5%, -100bps QoQ); ARV pricing pressure continues
- TP revised to Rs 540 (vs. Rs 645) as we pare FY23/FY24 EBITDA 7%/11% and lower our target EV/EBITDA to 16x (vs. 17x); cut from BUY to HOLD

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Synthesis remains at the helm: Laurus reported 31% YoY growth in Q2FY23 revenue to Rs 15.8bn primarily led by the synthesis division which grew 4.6x YoY (+25% QoQ) and contributed ~46% of revenue (vs. 37%/13% in Q1FY23/Q2FY22). Per management, growth was broad-based and supported by strong demand from existing clients, favourable contracting trends in general, and new project execution (possibly Paxlovid).

Generic APIs post strong growth: Generic API revenue grew 29% YoY (+17% QoQ) backed by new contract supplies, launches in the other API segment and volume-led growth in ARVs. Oncology APIs fell 36% YoY and 26% QoQ due to lower offtake in one key product. Management expects improvement from H2.

Dismal FDF performance; better mix masks margin impact: A product mix in favour of the high-margin synthesis business masked the impact of negative operating leverage from a steep drop in FDF revenue to Rs 1.5bn (-70% YoY, -57% QoQ in Q2; -51% in H1). FDF revenue was at its lowest in the last 12 quarters due to depressed pricing on account of high channel inventory, continued weak procurement from global agencies, a lack of long-term ARV formulation contracts and slower regulatory approvals for non-ARV formulations. Management expects improvement from Q3 with the potential grant of a supply contract from a global fund.

FY23 revenue target reduced; margins maintained: Given the depressed ARV pricing & demand uptick, Laurus now expects to achieve ~90% of its earlier guidance of US\$ 1bn in FY23. EBITDA margin guidance has been maintained at ~30%.

Downgrade to HOLD: Considering the steep decline in FDF performance, ARV pricing uncertainty, and management’s revised topline guidance, we cut FY23-FY24 EBITDA estimates by 7-11% and lower our target FY24E EV/EBITDA multiple to 16x (vs. 17x) – in line with last 5-year average. This yields a reduced TP of Rs 540 (vs. Rs 645) – downgrade from BUY to HOLD.

Key changes

	Target	Rating
	▼	▼

Ticker/Price	LAURUS IN/Rs 486
Market cap	US\$ 3.2bn
Free float	74%
3M ADV	US\$ 9.3mn
52wk high/low	Rs 626/Rs 437
Promoter/FPI/DII	27%/23%/5%

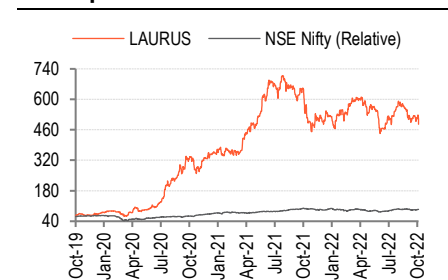
Source: NSE | Price as of 21 Oct 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	49,360	56,581	65,135
EBITDA (Rs mn)	14,229	16,409	18,889
Adj. net profit (Rs mn)	8,284	9,105	10,069
Adj. EPS (Rs)	15.4	17.0	18.8
Consensus EPS (Rs)	15.4	22.2	25.1
Adj. ROAE (%)	27.8	24.2	21.8
Adj. P/E (x)	31.5	28.7	25.9
EV/EBITDA (x)	19.3	17.0	14.8
Adj. EPS growth (%)	(14.3)	9.9	10.6

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Earnings call takeaways

- **FY23 revenue target delayed:** Management now expects a delay in achieving its aspirational FY23 revenue target of US\$ 1bn due to changes in the competitive landscape from adverse ARV API pricing and prolonged high channel inventory in ARV formulations. Delays in regulatory approvals will also impact launches. The company now expects to achieve only ~90% of its earlier guided figure of US\$ 1bn in FY23 (at a USDINR rate of 72).
- **Margins:** Management remains 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.
- **CDMO – Synthesis:** Synthesis growth in Q2FY23 was driven by strong demand from new as well as existing clients. Laurus currently has over 50 active projects at different stages (Phase I, II and III + CMO). Ongoing supplies for four commercial projects are underway.
- **FDF:** Continued weak procurement from global agencies and lower pricing due to high channel inventory resulted in a steep 70% YoY and 57% QoQ drop in FDF revenue in Q2.
- **Generic APIs:** New launches in the other API segment and volume-led growth in ARVs aided strong revenue growth in overall APIs (+29% YoY, +17% QoQ). **ARVs** grew 21% YoY and 8% QoQ backed by higher volumes. **Other APIs** consisting of cardiovascular, diabetes and anti-asthma therapies posted strong growth of 94% YoY (+60% QoQ) following new contract supplies. **Oncology API** revenue declined 36% YoY (-26% QoQ) due to lower offtake of one key product. Management expects improvement from H2FY23.
- **Bio division:** Management anticipates pickup with ramp-up of new capacities with large-scale CDMO partners in H2FY23.
- **Capacity expansion:** Construction work has commenced for creating a new R&D centre (by FY24) and three manufacturing units (FY24/FY25), all dedicated to CDMO activities. In FDF, unit-2 brownfield capacity was brought online last quarter and the company expects gradual ramp-up.
- **Capex:** The company incurred capex of Rs 4.2bn in H1FY23 (~13% of sales) and expect a similar number for the second half.
- **Tax rate:** Effective tax rate for H1FY23 was higher at 29% due to the change in SEZ profit exemption u/s 10AA to 50% for a period of five years from FY23. Laurus is evaluating a switch over to the composite rate.

Fig 1 – Quarterly performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Net Sales	15,759	12,035	30.9	15,389	2.4	31,148	24,820	25.5
EBITDA	4,489	3,451	30.1	4,542	(1.2)	9,031	7,404	22.0
Depreciation	818	632	29.5	708	-	1,526	1,217	-
EBIT	3,671	2,819	-	3,834	-	7,505	6,187	-
Interest	401	221	-	293	-	694	487	-
Other Income	11	28	-	18	-	29	87	-
PBT	3,281	2,626	24.9	3,559	(7.8)	6,840	5,786	18.2
Less: Taxation	943	586	60.8	1,033	-	1,976	1,331	-
Less: Minority Interest	10	21	-	13	-	23	23	-
Recurring PAT	2,328	2,019	15.3	2,513	(7.4)	4,841	4,433	9.2
Exceptional items	0	0	-	0	-	0	0	-
Reported PAT	2,328	2,019	15.3	2,513	(7.4)	4,841	4,433	9.2
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	55.1	55.7	(63)	57.6	(246)	56.3	56.2	10.1
EBITDA Margin	28.5	28.7	(19)	29.5	(103)	29.0	29.8	(83.9)
Tax / PBT	28.7	22.3	-	29.0	-	28.9	23.0	-
NPM	14.8	16.8	(200)	16.3	(155)	15.5	17.9	(231.9)
EPS (Rs)	4.3	3.8	15.3	4.7	(7.4)	9.0	8.3	9.2

Source: Company, BOBCAPS Research

Fig 2 – Segmental performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Generics – API	6,800	5,270	29.0	5,830	16.6	12,630	10,760	17.4
ARVs	4,080	3,373	21.0	3,790	7.7	7,870	7,490	5.1
Oncology	476	738	(35.5)	641	(25.8)	1,117	1,342	(16.7)
Other API	2,244	1,159	93.5	1,399	60.4	3,643	1,928	89.0
Synthesis	7,200	1,550	364.5	5,770	24.8	12,970	3,500	270.6
Formulations	1,490	4,950	(69.9)	3,490	(57.3)	4,980	10,160	(51.0)
Bio	270	260	3.8	300	(10.0)	570	400	42.5
Net Sales	15,759	12,035	30.9	15,389	2.4	31,148	24,820	25.5

Source: Company, BOBCAPS Research

Valuation methodology

Laurus continues to grapple with high industry-wide channel inventory, slower demand and pricing pressure in ARV formulations and APIs, though sequential growth over the last three quarters does hint at some demand normalisation in ARV APIs. The FDF segment posted dismal Q2FY23 revenue of Rs 1.5bn, its lowest in the last 12 quarters and a decline of Rs 3.7bn from its highest grossing quarter (Rs 5.2bn in Q1FY22). Though the company has adequate formulation capacity (10bn units), the division's contribution hinges on regulatory approvals, long-term ARV formulation tenders and better pricing.

Considering the weak FDF performance, ARV pricing uncertainty, and management's revised guidance, we cut FY23-FY24 EBITDA estimates by 7-11% and lower our target FY24E EV/EBITDA multiple to 16x (vs. 17x) – in line with last 5-year average. This yields a revised TP of Rs 540 (vs. Rs 645) – downgrade from BUY to HOLD.

Fig 3 – Revised estimates

(Rs bn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	56.6	65.1	63.2	73.1	(10.5)	(10.9)
EBITDA	16.4	18.9	17.7	21.2	(7.3)	(10.9)
EBITDA Margin (%)	29.0	29.0	28.0	29.0	100bps	0bps
EPS (Rs.)	17.0	18.8	18.8	22.0	(9.6)	(14.7)

Source: BOBCAPS Research

Fig 4 – Key assumptions

Revenue (Rs bn)	FY22A	FY23E	FY24E
Generic APIs	20.4	23.7	25.9
Generic FDF	18.8	13.2	15.8
Synthesis (CDMO)	9.2	18.3	21.7
Biotech	1.0	1.4	1.8

Source: Company, BOBCAPS Research

Fig 5 – 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	4,250	4.7	24.0	21.6	26.8	26.0	26.0
Laurus Labs	LAURUS IN	HOLD	540	14.9	17.0	14.8	26.3	26.4	16.0

Source: BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- revival in ARV pricing and demand,
- accelerated approval of new products and higher utilisation of FDF capacities, and
- long-term supply contract wins.

Key downside risks:

- higher concentration and pricing pressure in ARVs,
- delay in formulation business ramp-up
- adverse regulatory outcome on manufacturing facilities

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	1.9	1,232	1,500	BUY
Alembic Pharma	ALPM IN	1.3	543	770	HOLD
Alkem Labs	ALKEM IN	4.5	3,096	3,220	HOLD
Aurobindo Pharma	ARBP IN	3.7	524	695	BUY
Divi's Labs	DIVI IN	11.5	3,571	4,250	HOLD
Dr Reddy's Labs	DRRD IN	8.7	4,331	4,450	HOLD
Eris Lifesciences	ERIS IN	1.2	731	970	BUY
Glenmark Life Sciences	GLS IN	0.6	408	535	BUY
Laurus Labs	LAURUS IN	3.2	486	540	HOLD
Lupin	LPC IN	3.7	679	600	SELL
Sun Pharma	SUNP IN	28.3	978	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 21 Oct 2022

Glossary

API	Active Pharmaceutical Ingredient	FDF	Finished Dosage Form Division
CDMO	CDMO Synthesis Division	Bio	Biotechnology Division
CMO	Contract Manufacturing Organization Services		

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Total revenue	28,317	48,135	49,360	56,581	65,135
EBITDA	5,658	15,331	14,229	16,409	18,889
Depreciation	1,873	2,051	2,515	3,145	4,120
EBIT	3,785	13,280	11,714	13,264	14,770
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	12,140	13,426
Income taxes	383	3,173	2,514	3,035	3,356
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	9,105	10,069
Adjustments	0	0	0	0	0
Adjusted net profit	2,565	9,660	8,284	9,105	10,069

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Accounts payables	6,156	11,787	8,764	11,626	12,492
Other current liabilities	1,625	3,158	5,661	3,395	4,559
Provisions	568	757	892	1,022	1,177
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	40,637	49,726
Shareholders' fund	17,692	26,007	33,591	41,712	50,801
Total liab. and equities	37,497	57,507	69,680	78,529	89,802
Cash and cash eq.	17	485	759	1,706	1,897
Accounts receivables	7,914	13,061	13,542	15,347	17,667
Inventories	9,052	15,755	17,603	17,827	19,630
Other current assets	2,545	2,845	2,811	2,829	3,908
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	78,529	89,802

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Cash flow from operations	2,474	6,914	8,118	10,930	11,171
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	947	191
Closing cash & cash eq.	17	485	759	1,706	1,897

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22A	FY23E	FY24E
Reported EPS	4.8	18.0	15.4	17.0	18.8
Adjusted EPS	4.8	18.0	15.4	17.0	18.8
Dividend per share	1.5	1.5	1.5	1.5	1.5
Book value per share	33.0	48.4	62.5	77.5	94.4

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22A	FY23E	FY24E
EV/Sales	9.6	5.7	5.6	4.9	4.3
EV/EBITDA	48.0	17.8	19.3	17.0	14.8
Adjusted P/E	101.7	27.0	31.5	28.7	25.9
P/BV	14.7	10.0	7.8	6.3	5.1

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22A	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	91.5	90.9
EBIT margin (EBIT/Revenue)	13.4	27.6	23.7	23.4	22.7
Asset turnover (Rev./Avg TA)	25.4	33.9	25.7	24.2	24.3
Leverage (Avg TA/Avg Equity)	1.7	1.6	1.6	1.6	1.5
Adjusted ROAE	15.4	44.2	27.8	24.2	21.8

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
YoY growth (%)					
Revenue	23.6	70.0	2.5	14.6	15.1
EBITDA	58.1	171.0	(7.2)	15.3	15.1
Adjusted EPS	168.0	276.6	(14.3)	9.9	10.6
Profitability & Return ratios (%)					
EBITDA margin	20.0	31.9	28.8	29.0	29.0
EBIT margin	13.4	27.6	23.7	23.4	22.7
Adjusted profit margin	9.1	20.1	16.8	16.1	15.5
Adjusted ROAE	15.4	44.2	27.8	24.2	21.8
ROCE	13.8	38.1	24.7	22.9	22.2
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	1.1	1.1
Current ratio	2.3	2.0	2.3	2.4	2.4
Net interest coverage ratio	4.2	19.5	11.4	10.6	10.2
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%

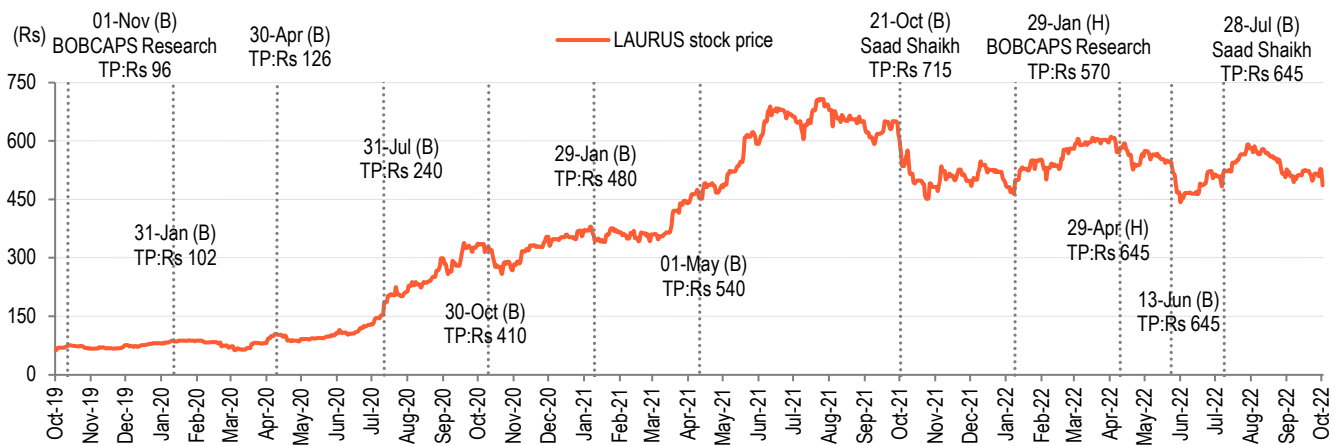
HOLD – Expected return from -6% to +15%

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

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