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PHARMACEUTICALS

15 February 2022

mRNA technology a threat to anti-HIV players

- **HIV vaccine development boosted by inclusion of the mRNA platform following its track record of rapid Covid-19 jab rollout**
- **Moderna recruiting volunteers for phase-1 trial of its mRNA HIV vaccine; experts expect successful outcome as early as CY23**
- **New vaccine likely to be prophylactic initially but may cause disruptions for Indian ARV majors LAURUS, ARBP and CIPLA**

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Strong potential for mRNA to transform vaccinology market: Given the frequent emergence of novel virus-led diseases such as Zika, Ebola, avian flu, swine flu, MERS, SARS and now SARS NCov-2 (Covid-19), a new platform to expedite vaccine development was the need of the hour as the traditional process takes over a decade. Further, diseases such as AIDS and herpes remain unaddressed since the 70s due to viral immune evasion. The advent of the flexible and efficient mRNA platform commercially and successfully used by companies such as Moderna to combat Covid fills this void. Both Pfizer/BioNtech and Moderna rolled out Covid vaccines using the mRNA platform within less than 12 months of genome sequence release by China.

mRNA application for HIV a natural corollary: With a massive cache of knowledge from a plethora of failed experiments in HIV vaccine development, mRNA technology offers the perfect platform to empower the human immune system to identify and raise a protective shield against HIV. This platform has the potential to match the agility and flexibility of the AIDS virus as it is fully equipped with the genome structure of all existing mutations, as chronicled by research foundations across nations.

Moderna begins trial of first mRNA HIV vaccine with key sponsors: Moderna has started recruiting volunteers for its phase-1 clinical trial of an mRNA HIV vaccine. It plans to enrol 56 healthy volunteers to test the safety of two variants of the same vaccine (mRNA-1644 and mRNA-164V2-Core), in collaborations with IAVI (International AIDS Vaccine Initiative) and BMGF (Bill and Melinda Gates Found.).

Headwinds for LAURUS, ARBP, CIPLA, Hetero if Moderna succeeds: Experts expect a successful outcome from Moderna trials as early as CY23. A potential HIV vaccine is likely to cause disruptions for large antiretroviral (ARV) majors such as LAURUS, ARBP, CIPLA (listed) and Hetero Drugs (unlisted). ARV sales with multilateral organisations and governments contribute 8-10% of revenues for Indian listed majors while the stakes are higher for Hetero and LAURUS (40-60% contribution from HIV drugs). However, we believe these threats are back-ended and expect CIPLA and ARBP to scale up their non-ARV sales in the interim. Maintain BUY on CIPLA (TP: Rs 1,160) and ARBP (TP: Rs 850) and HOLD on LAURUS (TP: Rs 570).

Recommendation snapshot

Ticker	Price	Target	Rating
ARBP IN	680	850	BUY
CIPLA IN	955	1,160	BUY
LAURUS IN	528	570	HOLD

Price & Target in Rupees | Price as of 14 Feb 2022

Contents

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Executive summary

- **ARV vaccine poses a risk to anti-HIV players:** Success of the mRNA technology in two Covid-19 vaccines (Pfizer/BioNtech and Moderna) during CY20 has opened up a new approach to addressing diseases such as HIV. However, the potential development of an mRNA-based ARV vaccine poses a threat to anti-HIV oral dosage players, including listed and unlisted Indian pharma companies who dominate this market.

- **mRNA platform a departure from conventional methods:** mRNA technology provides multiple benefits over conventional vaccines such as high potency, capacity for rapid development, potential low-cost manufacturing and safe administration. The speed and versatility of mRNA vaccine development is reflected in the rollout of Covid-19 vaccines in record time. Alteration to existing vaccines to tackle new versions of a virus is also possible with this platform.

- **Moderna recruiting volunteers for clinical trials of HIV vaccine:** After successful completion of pre-clinical trials on animals, Moderna has started recruiting volunteers for its phase-1 clinical trial of an mRNA HIV vaccine. The company plans to enrol 56 healthy volunteers to test the safety and efficacy of two variants of the vaccine (mRNA-1644 and mRNA-164V2-Core). This vaccine candidate is being developed in collaboration with IAVI and BMGF.

- **Short time for retrovirus to embed in genome posed challenges:** HIV vaccine development thus far has faced challenges as the retrovirus becomes part of the human genome (DNA) within 72 hours of transmission. Moreover, vaccine programmes failed to produce natural antibodies that could fight HIV as the virus penetrates cells without raising the immunity alarm and becomes part of the DNA.

- **Fast mutations to meet their match in mRNA vaccines:** While multiple attempts to develop an HIV vaccine have met with failure, these efforts have served to populate a vast database with unprecedented details on the numerous mutated variants of the AIDS virus over the years. This helps researchers to stabilise the fast-changing HIV mutants and also understand its outer (envelop) forms, which were the main reasons for the failure of so many vaccine candidates to date. mRNA technology, being flexible and easily modified, is best placed to cope with the fast-mutating HIV variants.

- **No remedy available for HIV since mid-1970s:** The AIDS epidemic that began in the mid-to-late 1970s is marked by two major virus types: HIV-1 (widespread and first discovered) and HIV-2. The current global HIV population of 38mn with 2mn incremental infections each year continues to take an economic toll, especially in LMIC regions, lending an impetus to the race for immunisation. At present, there are no remedies for the disease but treatment options (mainly oral solid dosages) called ARTs (antiretroviral therapies) help slow its progression and reduce transmission.

- **CIPLA – pioneer in supplying affordable ARV drugs to the world:** Generic ARV therapies, formulations and APIs put together contributed 10% (Rs 18.5bn) of Cipla's FY21 revenue. In India, Cipla ranks second with 17% of its domestic revenue coming from ARV therapies. In the South Africa private market, it is ranked fourth in ARV therapies with an 18.2% market share. About 7% of the company's

total SAGA sales consist of ARV drugs. We reiterate BUY on the stock with an unchanged TP of Rs 1,160.

- **ARBP – third-largest Indian ARV player:** Aurobindo Pharma (ARBP) draws 8% (Rs 18.6bn) of overall revenues from the ARV tender business and is the third largest company among ARV majors globally. It has supplied lifesaving drugs to 3mn HIV patients across 125+ countries and filed over 1,100 ARV dossiers for registrations across the globe. ARBP's ARV revenue has logged a 12% CAGR over five years and clocked a 49% YoY increase in FY21 on the back of its early mover advantage in triple combination (TLD) drugs vs. old generation TLE. We retain BUY on the stock and maintain our TP of Rs 850.

- **LAURUS – global leader in ARV APIs:** Laurus Labs (LAURUS) is a leading manufacturer globally of select APIs, including molecules in ARV, Hepatitis C, and oncology therapeutic areas. The company is the preferred API supplier for global ARV majors, has a large manufacturing capacity and economies of scale, with ARVs contributing two-third of its revenues. With new approval for TLD combination drug, Laurus plans to initiate a price war with early entrants and expects to capture a major market share in the tender business by FY24. We maintain HOLD with an unchanged TP of Rs 570.

Fig 1 – Valuation snapshot

Ticker	Price	Target	Recommendation
ARBP IN	700	850	BUY
CIPLA IN	959	1,160	BUY
LAURUS IN	550	570	HOLD

Source: BOBCAPS Research

mRNA technology a game changer

Success of the mRNA technology in two Covid-19 vaccines – Pfizer/BioNtech and Moderna – has opened up an exciting and novel approach to addressing terminal illnesses such as HIV and cancer, endocrinology disorders and communicable diseases such as malaria and TB, given the vaccine platform's rapid development timeframe, flexibility and easy modification characteristics. We focus on HIV immunisation in particular, which has met with several failed attempts over the years but where experts now foresee a successful outcome from Moderna's mRNA vaccine trials by CY23.

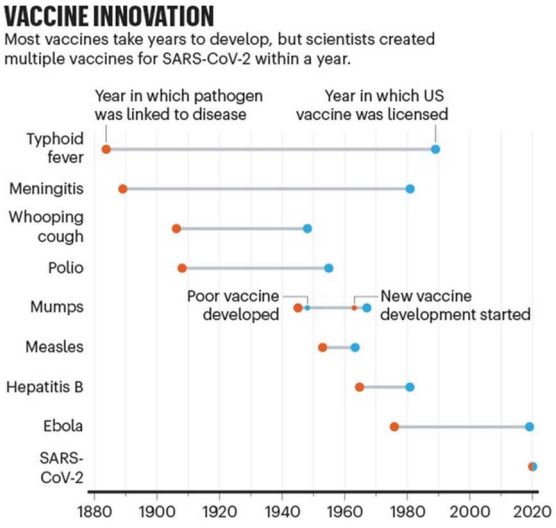
HIV – the holy grail of vaccine makers

About 38mn people are infected by HIV the world over, of which 36mn are adults and 2mn are juveniles. The US has a population of 2mn infected by the virus. Annually, the world registers 2mn new HIV infections and 690,000 deaths due to complications from the disease. It also carries a significant economic burden with US$ 562bn spent over CY00-CY15 on care, treatment and prevention. Given the steady rise in HIV patients globally, the healthcare burden is mounting on governments and multilateral organisations – making an AIDS vaccine the holy grail for the medical community.

During the Covid-19 pandemic, concerted social, financial and political support worldwide saw vaccine makers receive funding from governments, multilateral foundations and commercial corporations. This enabled the rapid rollout of Covid vaccines in Dec'20 – including two mRNA candidates from Pfizer/BioNtech and Moderna – less than a year after release of the coronavirus genome sequence by Chinese scientists.

While there has been strong support and funding for HIV from all constituents since 1990, the only missing piece has been the technology to combat the virus effectively. In our view, mRNA technology is that missing piece and will most likely replicate the rapid success of Covid-19 vaccine development in the HIV sphere by CY23. Further, UNAIDS' target of taming the HIV epidemic to a low-level endemic disease by CY30 should drive funding of vaccines (if successful) for LMIC markets.

Fig 2 – mRNA has revolutionised vaccine development



Source: www.nature.com

mRNA promising vs. conventional platforms

The mRNA platform offers a promising alternative to the conventional approach to developing vaccines due to its high potency, capacity for rapid development, potential for low-cost manufacturing and safe administration. With recent technological advances in delivery mechanisms, researchers now favour mRNA as the preferred vaccine platform of the future for a wide range of therapeutic areas, especially infectious diseases and terminal illnesses such as cancer and HIV.

Conventional vaccines follow the route of inactivated pathogens and offer durable protection against several diseases. Researchers have, however, faced major hurdles in developing vaccines for several infectious diseases due to intelligent pathogens that are able to evade the adaptive immune system and remain incurable. Rapid development and widespread deployment are other key obstacles to the conventional approach.

In contrast, speed and versatility make mRNA technology a boon for researchers. While the mumps vaccine was developed the fastest, in four years in the 1960s, vaccines against SARS-COV-2 (Covid-19) were rolled out in less than 12 months by Pfizer/ BioNTech in CY20. This has challenged the whole paradigm of vaccine development, given validation from the Covid-19 response that the process can be accelerated substantially without compromising on safety. Researchers believe that a series of vaccine shots will likely be required to coax the immune system into making the right kind of antibodies to protect against HIV.

Key benefits of mRNA over inactivated vaccines

- **Safety:** mRNA is a non-infectious and non-integrating platform and hence there is no risk of mutagenesis or genetic mutation. Also, it can be degraded by normal cellular process and regulated through a modifications and delivery process.
- **Efficacy:** Various modifications make mRNA more stable and highly translatable. It is a minimal genetic vector and hence avoids drawing anti-vector immunity (which may cause serious complications if the vector, such as adenovirus, occurs in a human cell, leading to reduced effectiveness of the vaccine).
- **Production:** Any vaccine using mRNA technology has the potential to facilitate rapid, inexpensive and scalable manufacturing capability.

Fig 3 – Clinical trials with mRNA vaccines against infectious diseases

Sponsoring institution	Vaccine type (route of administration)	Targets	Trial numbers (phase)	Status
Argos Therapeutics	DC EP with autologous viral Ag and CD40L mRNAs (i.d.)	HIV-1	• NCT00672191 (II) • NCT01069809 (II) • NCT02042248 (I)	• Completed • Completed; results NA • Completed; results NA
CureVac AG	RNActive viral Ag mRNA (i.m., i.d.)	Rabies virus	NCT02241135 (I)	Active
Erasmus Medical Center	DC loaded with viral Ag mRNA with TriMix (i.nod.)	HIV-1	NCT02888756 (II)	Recruiting
Fundació Clínic per la Recerca Biomèdica	Viral Ag mRNA with TriMix (NA)	HIV-1	NCT02413645 (I)	Active
Massachusetts General Hospital	DC loaded with viral Ag mRNA (i.d.)	HIV-1	NCT00833781 (II)	Completed
McGill University Health Centre	DC EP with autologous viral Ag and CD40L mRNAs (i.d.)	HIV-1	NCT00381212 (I/II)	Completed
Moderna Therapeutics	Nucleoside-modified viral Ag mRNA (i.m.)	Zika virus	NCT03014089 (I/II)	Recruiting
		Influenza virus	NCT03076385 (I)	Ongoing

Source: www.nature.com

Moderna begins trials of experimental mRNA HIV vaccine

Moderna began recruiting volunteers for its phase-1 clinical trial of an mRNA HIV vaccine from the third week of Sep'21 (Source: clinicaltrials.gov). It plans to enrol 56 healthy volunteers (without HIV) to test the safety of two variants of the same vaccine – mRNA-1644 and mRNA-164V2-Core – and their efficacy in encouraging a basic immune response. The candidate is being developed in collaboration with IAVI and BMGF.

The company has another prophylactic (preventive/protective) anti-HIV vaccine, mRNA-1574, which is currently in the pre-clinical stage (animal testing) with funding support from BMGF and NIAID (US). A clinical trial is planned for CY22. The mRNA-1574 vaccine uses novel HIV trimmer designs to prevent disease in healthy patients.

Fig 4 – Moderna's mRNA vaccines

Modality	Program	ID #	Preclinical Development	Phase 1	Phase 2	Phase 3	Commercial	Moderna Rights
Prophylactic Vaccines	CMV vaccine	mRNA-1647						Worldwide
	EBV prophylactic vaccine	mRNA-1189						Worldwide
	EBV therapeutic vaccine	mRNA-1195						Worldwide
	Zika vaccine	mRNA-1893						Worldwide BARDA funded
	HIV vaccine	mRNA-1644						Worldwide IAVI/others funded
		mRNA-1574						Worldwide BMGF/NIAID/ others funded
	Nipah vaccine	mRNA-1215						Worldwide NIH funded

Source: Moderna

Why mRNA has a better probability of success

HIV evades the immune system and can survive in the body for over four decades. A key factor behind this is the virus' ability to rapidly evolve and produce new mutations which elude the immune system. The mutated HIV camouflages its outer layer (the HIV envelop glycoprotein or HIV env) with the same sugar chains found on human proteins, helping it hide from the immune system. Like the coronavirus, the HIV ensures spike proteins to enter human cells and infect them. mRNA technology, being flexible and easily modified, is best placed to cope with this fast-mutating virus.

Efforts at conventional vaccines unfruitful

Creating an HIV vaccine thus far has been challenging because the retrovirus becomes part of the human genome (DNA) within 72 hours of transmission. The basic difficulty observed in all vaccines tested in human trials was that they failed to produce broadly natural antibodies (or bnAbs) necessary to block HIV in target cells due to the ever-changing nature of the virus.

While repeated attempts to develop an HIV vaccine have met with failure, these efforts have served to populate a vast database with unprecedented details on the numerous mutated variants over the years. This has helped researchers to both stabilise the fast-changing HIV mutants and provided a deep understanding of its outer (envelop) forms.

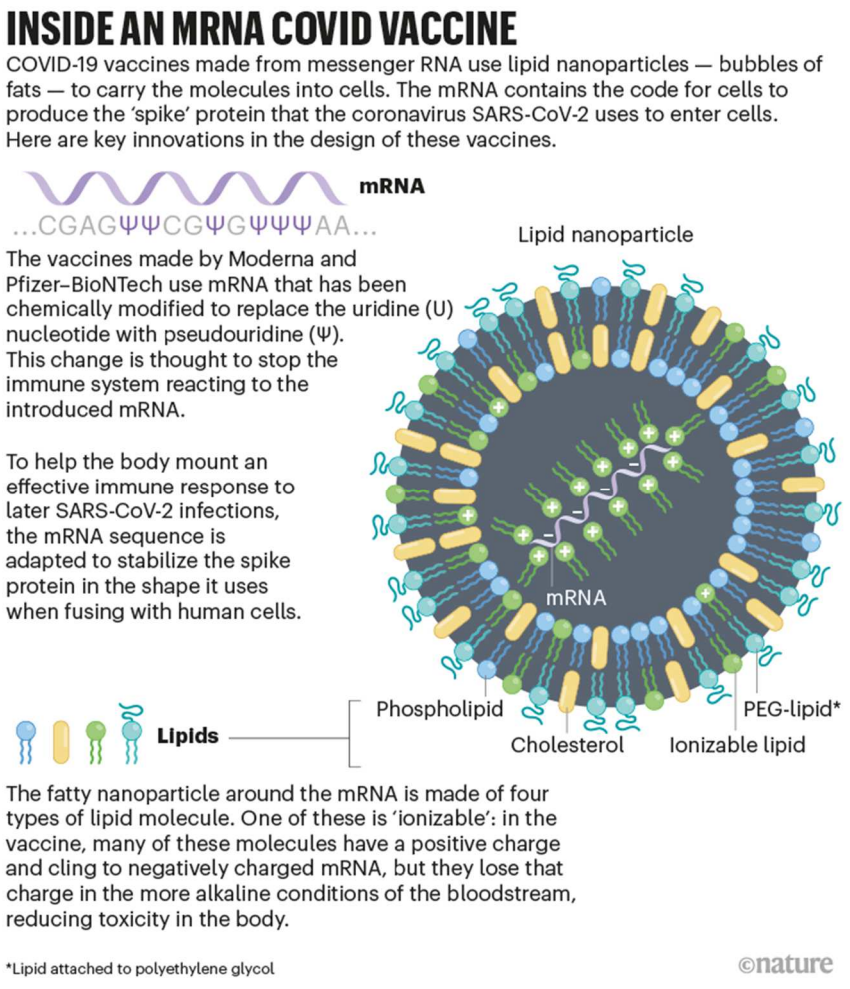
‘Messenger’ RNA could change the status quo

The mRNA is a molecule that essentially delivers instructions to cells to build certain proteins. After studying the role of bnAbs in neutralising HIV in lab tests, IAVI developed lab-engineered immunogens – a substance that induces immune response – which carries detailed knowledge of the outer surface of the virus.

The Moderna trials will explore the efficacy of the mRNA technology platform to deliver these immunogens and direct cells to produce proteins that will elicit an immune response against HIV. This platform can match the agility and flexibility of the AIDS virus as it is fully equipped with the genome structure of all mutated forms, as chronicled by research foundations across nations.

Before the mRNA study, IAVI and SCRIPPS in CY18 tested a part of the Moderna vaccine, the immunogens, on 48 healthy subjects but using a non-mRNA system. The results were encouraging as 97% of the subjects who received the vaccine generated the desired response of producing bnAbs. This indicates a high possibility of success for the Moderna trials as it will now repeat the study using mRNA technology (see Annexure B on Page 10 for details).

Fig 5 – Innovations in mRNA vaccine design



Source: www.nature.com

Potential headwinds for ARV players

At present, there is no cure for HIV but treatment options (mainly oral solid dosages) called ARTs help slow progression of the disease and reduce transmission. With the active participation of a few large multilateral organisations, the treatment and reach of ARTs covered 27.5mn patients (out of 37.7mn) in CY20 in comparison to 8mn in CY10 and over 23mn patients in CY18 (Sources: CHAI and The Global Fund). The introduction of Dolutegravir (DTG) in CY13 changed the global landscape and it is now a key drug for first- and second-line treatments.

Experts expect Moderna to achieve a successful outcome from clinical trials of its HIV vaccine by CY23, which would upset the applecart for large anti-HIV drug manufacturers. This includes Indian majors such as LAURUS, ARBP, CIPLA (listed) and Hetero Drugs (unlisted) who currently dominate the supply of ARTs to various markets globally. The tender business with multilateral organisations and the Indian government contributes 8-10% of consolidated revenues for Indian listed majors while the stakes are higher for Hetero and LAURUS (40-60% contribution from HIV drugs).

Annexure A

HIV and AIDS

HIV is the virus responsible for acquired immunodeficiency syndrome (AIDS) – a terminal illness. AIDS once acquired is a progressive, lifelong illness with no effective cure. The infection is spread in two ways: (1) predominantly by unsafe sexual intercourse, and (2) by unsterilised injections (IV).

Messenger RNA (mRNA)

The mRNA is a molecule that essentially delivers instructions to cells to build certain proteins. French scientists Jacques Monod and François Jacob first suggested the concept of mRNA in human cells in 1961. Their hypothesis was first raised by Watson and Crick during their discovery of DNA in 1951. The discovery of DNA unveiled genetic code that emits signals to the body's cells to produce proteins required to function healthily.

While the discovery made ground breaking genetic code, what remained unanswered was who send messages to the cells to produce proteins. DNA is found in the nucleus of a cell while cytoplasm (that produce proteins as per the instructions of the DNA) stays in a totally distinct cellular compartment. Monod and Jacob raised the hypothesis that there must be some intermediate molecule that transports the information from the DNA to the cytoplasm (protein-making factory) – the "messenger" or transporter is the "m" in mRNA.

An mRNA vaccine transports the synthetic code (message) of the antigen of the virus and teaches the cell to produce a protein similar to that produced by the targeted virus (in this case HIV). Once these proteins are produced, it will activate the immune system further to identify and fight the targeted virus before it enters the cell.

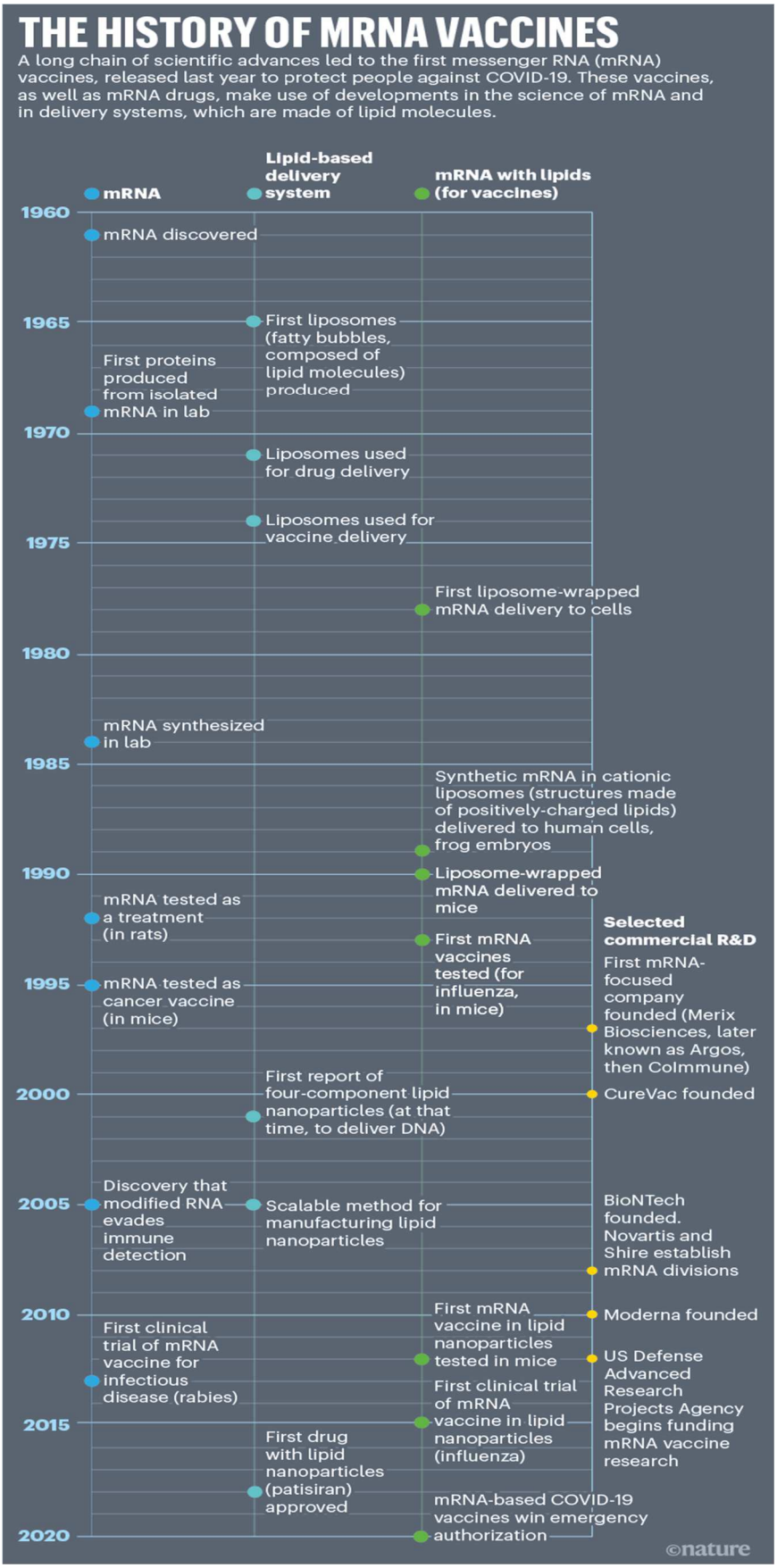
Annexure B

Moderna mRNA study designs

Before the mRNA study, IAVI and SCRIPPS (IAVI G001 in CY18) tested a part of the Moderna vaccine, the immunogens, on 48 healthy subjects but using a non-mRNA system. This was a blind study with a placebo two months apart. The result was encouraging as 97% of the subjects who received the vaccine generated the desired response of producing bnAbs through altering the naive B cells.

Following this study, IAVI and SCRIPPS tied up with Moderna to redesign the study on the mRNA technology platform to be applied to 56 adults aged 18-50 years divided into four groups. Two groups are to receive a mix of two variants of the vaccine (mRNA-1644 and mRNA-164v2-core) while the other two groups will get only one of the two vaccines. The trials will not be blind as participants shall know which type of vaccines are used. The technology is likely to accelerate the discovery and development of B-cells and bnAbs for a duration of 19 months (May CY23E).

Fig 6 – History of mRNA vaccines



Source: www.nature.com


Companies

BUY
TP: Rs 850 | ▲ 25%

AUROBINDO PHARMA | Pharmaceuticals | 15 February 2022

Demerger of injectable business to drive growth

- **Third-largest generic ARV manufacturer by revenue with 12% CAGR in ARV revenues over last five years**
- **Injectable business and rich formulation pipeline for the US market to drive growth with 40+ planned launches**
- **Retain BUY with TP unchanged at Rs 850 based on 7.5x FY24E EV/EBITDA**

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Third-largest Indian ARV player: ARBP draws 8% (Rs 18.6bn) of revenue from the ARV tender business and is the third-largest ARV player globally. It has supplied life-saving drugs to 3mn HIV patients across 125+ countries and filed over 1,100 ARV dossiers for registration across the globe. ARBP's ARV revenue has logged a 12% CAGR over five years and a 49% YoY increase in FY21. The company has garnered significant market share in Dolutegravir with an early-mover advantage in the TLD single pill regimen (Tenofovir 300mg + Lamivudine 300mg + Dolutegravir 50mg tablet) along with the rapid conversion of TLE to TLD in the institutional segment.

Injectables a primary growth driver: The injectable business is an important growth engine for the company and ARBP has an ambitious target of taking it to US$ 700mn in FY24 from US$ 500mn in FY21. It currently has 101 approved injectable ANDAs and 54 under review. Plans for demerging the injectable business are underway, which will unlock further value. The company has completed construction of a dedicated injectable facility in the US for high-value, low-volume products. This will mitigate the regulatory risk on Unit-VII in Hyderabad.

Rich US pipeline: The US formulations business which contributes 50% of consolidated revenue has a rich pipeline of 196 ANDAs under review and 29 tentative approvals till H1FY22. Armed with a strong pipeline, ARBP has guided for the launch of more than 40 ANDAs.

Maintain BUY: ARBP trades at an attractive 7.1x/5.7x FY23E/FY24E EV/EBITDA. Our TP of Rs 850 is based on 7.5x FY24E EV/EBITDA, a 45% discount to other frontline stocks (SUNP, CIPLA, DRRD) due to ARBP's low branded sales and high US exposure. Operational headwinds such as US price erosion, channel destocking, regulatory observations, investment/withdrawal of unrelated M&A and top leadership changes have generated negative sentiment and higher execution risk to its guidance.

However, the domestic formulations foray, launch of biosimilars/complex products and injectables demerger offer opportunities for value unlocking which could drive a rerating as visibility improves. Retain BUY.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	ARBP IN/Rs 680
Market cap	US$ 5.3bn
Free float	48%
3M ADV	US$ 19.7mn
52wk high/low	Rs 1,064/Rs 590
Promoter/FPI/DII	52%/22%/16%

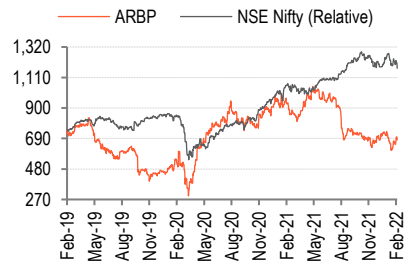
Source: NSE | Price as of 14 Feb 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	2,47,746	2,38,108	2,64,197
EBITDA (Rs mn)	53,334	45,792	55,779
Adj. net profit (Rs mn)	25,203	27,825	34,726
Adj. EPS (Rs)	43.0	47.5	59.3
Consensus EPS (Rs)	43.0	52.0	59.2
Adj. ROAE (%)	12.9	11.9	13.3
Adj. P/E (x)	15.8	14.3	11.5
EV/EBITDA (x)	8.2	9.0	6.9
Adj. EPS growth (%)	(12.2)	10.4	24.8

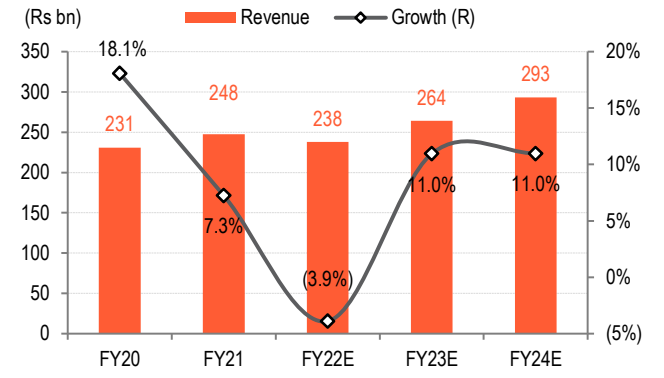
Source: Company, Bloomberg, BOBCAPS Research

Stock performance



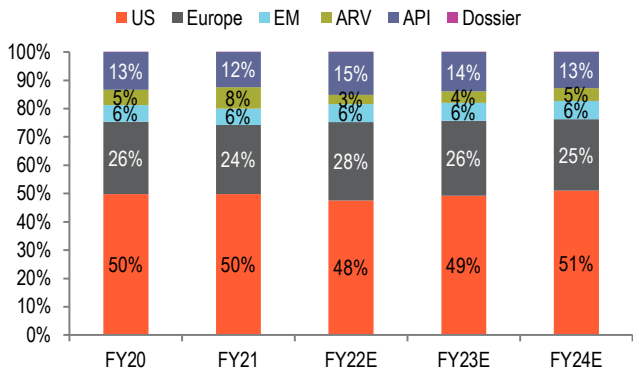
Source: NSE

Fig 1 – Revenue and growth matrices



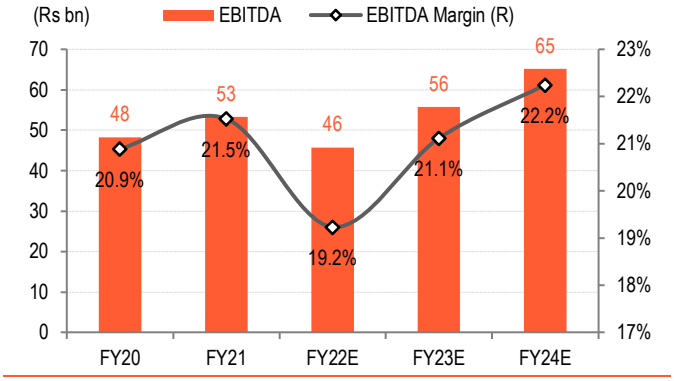
Source: Company, BOBCAPS Research

Fig 2 – Revenue mix



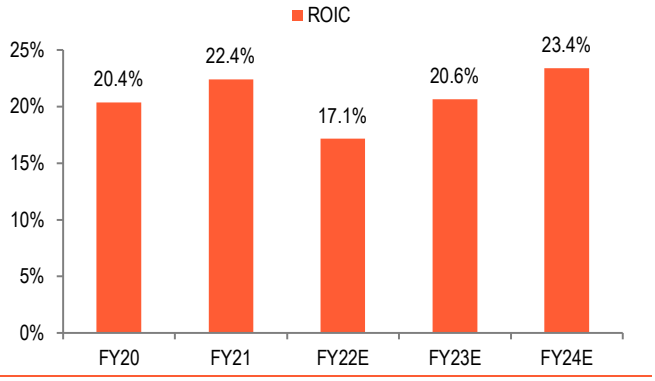
Source: Company, BOBCAPS Research

Fig 3 – EBITDA margin to remain at 23% in FY23E-FY24E



Source: Company, BOBCAPS Research

Fig 4 – ROIC to improve



Source: Company, BOBCAPS Research

Valuation methodology

ARBP continues to face challenges in the US market in terms of pricing erosion and raw material price inflation, which have dampened gross and EBITDA margins over the past few quarters, in line with the industry. Its ARV sales have declined 57% YoY in 9MFY22 primarily due to lower demand off a higher base and shelf stock adjustments.

Nevertheless, we are optimistic about the company's growth prospects on the back of the injectables business where management has a target of achieving US$ 650mn-700mn in sales by FY24. This apart, ARBP has announced its foray into the domestic branded formulations market and expects to achieve revenue of Rs 10bn in a three-year timeframe.

The stock is trading at an attractive 7.1x/5.7x FY23E/FY24E EV/EBITDA. Our TP of Rs 850 is based on 7.5x FY24E EV/EBITDA, a 45% discount to other frontline stocks (SUNP, CIPLA, DRRD) due to ARBP's low branded sales and high US exposure. Operational headwinds such as US price erosion, channel destocking, regulatory observations, investment/ withdrawal of unrelated M&A and top leadership changes have generated negative sentiment and higher execution risk to its guidance. However, the domestic formulations foray, launch of biosimilars/complex products and injectables demerger offer opportunities for value unlocking which could drive a rerating as visibility improves. Retain BUY.

Fig 5 – Key assumptions

Revenue (Rs bn)	FY21	FY22E	FY23E	FY24E
US	123.2	113.1	130.1	149.6
Europe	60.6	65.8	69.7	73.8
EM	14.4	15.1	16.9	18.9
ARV	18.6	7.9	10.7	13.4
API	30.9	36.1	36.8	37.4
Dossier Income	0.0	0.0	0.0	0.0

Source: Company, BOBCAPS Research

Fig 6 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY21-24E (%)	EV/EBITDA (x)		ROE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Aurobindo	ARBP IN	BUY	850	6.9	6.7	5.7	13.3	13.9	7.5
Cipla	CIPLA IN	BUY	1,160	11.0	14.6	12.9	13.6	14.5	16.0
Dr. Reddy's	DRRD IN	HOLD	4,700	10.6	11.7	11.1	17.2	15.5	12.5
Sun Pharma	SUNP IN	BUY	1,045	14.9	16.3	14.6	16.1	16.1	18.0

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- **Regulatory issues at multiple plants:** ARBP's Units 1, 9 and 11 are under observation with a warning letter dogging Unit 11 for more than 18 months. In Jan'22, it received a warning letter for Unit 1 which reduces the possibility of resolution for all the three API/intermediate plants in the medium term.
- **Price erosion in base portfolio:** Price erosion in the core portfolio along with lower footfalls at hospitals could delay growth in the near term.
- **Channel destocking in the US:** FY21 saw strong revenue growth and high EBITDA margins due to strong demand from channel partners to address uncertainty over the availability of key generics and logistical restrictions. This has led to destocking in FY22 which could partly spillover into FY23 as well.

Sector recommendation snapshot

Company	Ticker	Market Cap (US$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.3	2,031	2,655	BUY
Alembic Pharma	ALPM IN	1.9	737	905	BUY
Alkem Labs	ALKEM IN	5.3	3,365	4,000	HOLD
Aurobindo Pharma	ARBP IN	5.3	680	850	BUY
Cipla	CIPLA IN	10.2	955	1,160	BUY
Divi's Labs	DIVI IN	15.0	4,278	5,250	BUY
Dr Reddy's Labs	DRRD IN	9.2	4,205	4,700	HOLD
Eris Lifesciences	ERIS IN	1.3	696	890	BUY
Laurus Labs	LAURUS IN	3.8	528	570	HOLD
Sun Pharma	SUNP IN	27.5	865	1,045	BUY

Source: BOBCAPS Research, NSE | Price as of 14 Feb 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	**2,30,986**	**2,47,746**	**2,38,108**	**2,64,197**	**2,93,199**
EBITDA	48,247	53,334	45,792	55,779	65,220
Depreciation	9,667	10,554	11,798	13,487	14,745
EBIT	38,580	42,780	33,994	42,291	50,475
Net interest inc./(exp.)	(1,598)	(745)	(545)	(385)	(270)
Other inc./(exp.)	862	3,808	3,650	4,395	4,947
Exceptional items	0	0	0	0	0
EBT	37,844	45,844	37,100	46,301	55,152
Income taxes	8,994	20,098	9,275	11,575	13,788
Extraordinary items	(261)	28,146	500	0	0
Min. int./Inc. from assoc.	137	543	0	0	0
Reported net profit	**28,452**	**53,349**	**28,325**	**34,726**	**41,364**
Adjustments	261	(28,146)	(500)	0	0
Adjusted net profit	**28,714**	**25,203**	**27,825**	**34,726**	**41,364**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	25,450	27,947	32,618	36,191	40,164
Other current liabilities	30,745	29,831	28,573	31,704	35,184
Provisions	4,914	3,291	3,162	3,509	3,894
Debt funds	56,867	52,373	41,898	33,519	23,463
Other liabilities	0	0	0	0	0
Equity capital	586	586	586	586	586
Reserves & surplus	1,68,912	2,19,923	2,45,327	2,77,123	3,15,558
Shareholders' fund	1,69,498	2,20,509	2,45,913	2,77,709	3,16,144
Total liab. and equities	**2,87,473**	**3,33,950**	**3,52,164**	**3,82,632**	**4,18,849**
Cash and cash eq.	28,422	54,680	67,000	79,512	97,173
Accounts receivables	43,552	35,033	58,712	65,145	72,296
Inventories	76,999	90,266	71,759	79,621	88,361
Other current assets	19,130	23,711	21,430	23,778	26,388
Investments	5,547	5,910	5,910	5,910	5,910
Net fixed assets	64,948	68,866	71,868	73,181	73,235
CWIP	19,859	30,615	30,615	30,615	30,615
Intangible assets	29,017	24,870	24,870	24,870	24,870
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	**2,87,474**	**3,33,950**	**3,52,164**	**3,82,632**	**4,18,849**

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	**45,455**	**55,279**	**41,061**	**39,006**	**45,716**
Capital expenditures	(17,500)	(14,000)	(14,800)	(14,800)	(14,800)
Change in investments	(1,945)	(363)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	**(19,445)**	**(14,363)**	**(14,800)**	**(14,800)**	**(14,800)**
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(12,800)	(4,494)	(10,475)	(8,380)	(10,056)
Interest expenses	(1,598)	(745)	(545)	(385)	(270)
Dividends paid	(2,930)	(2,930)	(2,930)	(2,930)	(2,930)
Other financing cash flows	144	(6,489)	9	0	0
Cash flow from financing	**(17,184)**	**(14,658)**	**(13,940)**	**(11,695)**	**(13,255)**
Chg in cash & cash eq.	**8,827**	**26,258**	**12,321**	**12,512**	**17,661**
Closing cash & cash eq.	**28,421**	**54,680**	**67,001**	**79,512**	**97,173**

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	48.6	91.1	48.3	59.3	70.6
Adjusted EPS	49.0	43.0	47.5	59.3	70.6
Dividend per share	2.5	2.5	2.5	2.5	2.5
Book value per share	289.6	376.8	420.2	474.6	540.2

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	1.9	1.8	1.7	1.5	1.2
EV/EBITDA	9.1	8.2	9.0	6.9	5.6
Adjusted P/E	13.9	15.8	14.3	11.5	9.6
P/BV	2.3	1.8	1.6	1.4	1.3

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	75.9	55.0	75.0	75.0	75.0
Interest burden (PBT/EBIT)	98.1	107.2	109.1	109.5	109.3
EBIT margin (EBIT/Revenue)	16.7	17.3	14.3	16.0	17.2
Asset turnover (Rev./Avg TA)	26.5	24.8	21.2	22.1	22.5
Leverage (Avg TA/Avg Equity)	1.4	1.3	1.2	1.1	1.1
Adjusted ROAE	18.6	12.9	11.9	13.3	13.9

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	18.1	7.3	(3.9)	11.0	11.0
EBITDA	22.1	10.5	(14.1)	21.8	16.9
Adjusted EPS	19.0	(12.2)	10.4	24.8	19.1
Profitability & Return ratios (%)					
EBITDA margin	20.9	21.5	19.2	21.1	22.2
EBIT margin	16.7	17.3	14.3	16.0	17.2
Adjusted profit margin	12.4	10.2	11.7	13.1	14.1
Adjusted ROAE	18.6	12.9	11.9	13.3	13.9
ROCE	18.1	18.7	13.4	15.6	17.0
Working capital days (days)					
Receivables	69	52	90	90	90
Inventory	122	133	110	110	110
Payables	40	41	50	50	50
Ratios (x)					
Gross asset turnover	1.9	1.8	1.6	1.6	1.6
Current ratio	2.8	3.3	3.4	3.5	3.6
Net interest coverage ratio	24.1	57.4	62.4	109.7	187.1
Adjusted debt/equity	0.2	0.0	(0.1)	(0.2)	(0.2)

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

BUY
TP: Rs 1,160 | ▲ 21%

CIPLA

| Pharmaceuticals | 15 February 2022

Rich pipeline, US complex generic approval to spur growth

- **Strong India franchise, robust pipeline and low risk of price erosion in US market to bolster topline**
- **Expect high growth in domestic branded/trade generics and consumer health divisions with One-India strategy**
- **High-value pipeline slated for H2FY23 launch. Reiterate BUY; TP unchanged at Rs 1,160**

Surajit Pal | Saad Shaikh
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Pioneer in supplying affordable ARV drugs to the world: Generic ARV therapies, formulations and APIs put together contributed 10% (Rs 18.5bn) of Cipla's FY21 revenue. In India, Cipla ranks second with 17% of domestic revenue coming from ARV therapies. In the South Africa private market, it is ranked fourth in ARV therapies with an 18.2% market share. About 7% of the company's total SAGA sales consist of ARV drugs.

First to introduce US$ 1 per day medicine for HIV patients: Cipla pioneered the world's first-ever recommended 3-in-1 fixed dose combination (Stavudine + Lamivudine + Nevirapine) in CY01, disrupting high-priced ARV drugs with its medication priced at less than US$ 1 per day or ~US$ 365 per year in comparison to over US$ 12,000 per year by other pharma majors. The company has developed over 15 single and combination medicines that revolutionised HIV therapy across poor countries and caters to ~1mn HIV patients across the world.

Delivery of efficient drugs from existing molecules: With the USFDA's approval of 25 molecules under PEPFAR as well as pre-qualification from WHO, Cipla has the widest portfolio of ARV products. Its HIV drugs are supplied to more than 115 countries as part of government-led schemes and sponsorship programmes of multilateral charitable organisations (such as CHAI, Gates Foundation and the Global Fund).

Maintain BUY, TP Rs 1,160: With a strong India franchise, rich US pipeline and low risk of price erosion in the US (top 3 products form 25% of US sales), Cipla is poised to leverage its robust core sales to launch major generics. We expect operating leverage in the US business to be a key margin driver for the next two years. We reiterate BUY and retain our TP at Rs 1,160 based on 16x FY24E EV/EBITDA (implied P/E of 26x). Our target multiple is at the midpoint of the stock's 10-year historical band (12-22x).

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	CIPLA IN/Rs 955
Market cap	US$ 10.2bn
Free float	63%
3M ADV	US$ 30.5mn
52wk high/low	Rs 1,005/Rs 738
Promoter/FPI/DII	36%/25%/21%

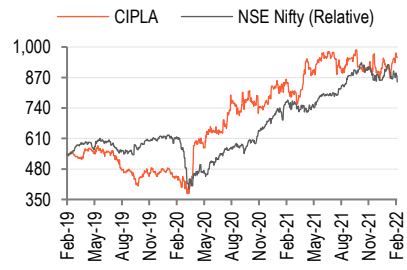
Source: NSE | Price as of 14 Feb 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	1,90,682	2,15,698	2,34,785
EBITDA (Rs mn)	41,611	47,567	50,362
Adj. net profit (Rs mn)	23,135	27,604	29,768
Adj. EPS (Rs)	28.7	34.3	36.9
Consensus EPS (Rs)	28.7	35.1	41.7
Adj. ROAE (%)	13.5	14.2	13.6
Adj. P/E (x)	33.3	27.9	25.8
EV/EBITDA (x)	18.8	16.0	14.7
Adj. EPS growth (%)	57.3	19.3	7.8

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

Other business highlights

Complex generics, respiratory, specialty portfolio to drive US generics

Cipla continues to focus on limited-competition and complex generics and has products such as Revlimid, Abraxane and Advair in the pipeline. It is likely to launch key drugs such as Advair Diskus (H2FY23E) and QVAR (FY24E) in the medium term. Advair Diskus is a meaningful opportunity with a market size of more than US$ 1bn.

Operating leverage in the US to be key margin driver near term

We expect operating leverage in the US business to be a key margin driver for FY22-FY24. We believe CIPLA's future investments will have a sharper focus on opportunities in high-value/complex assets which also support better margins. The company continues to strengthen its revenue streams with a differentiated portfolio, product development capabilities and de-risking of the supply chain across its markets.

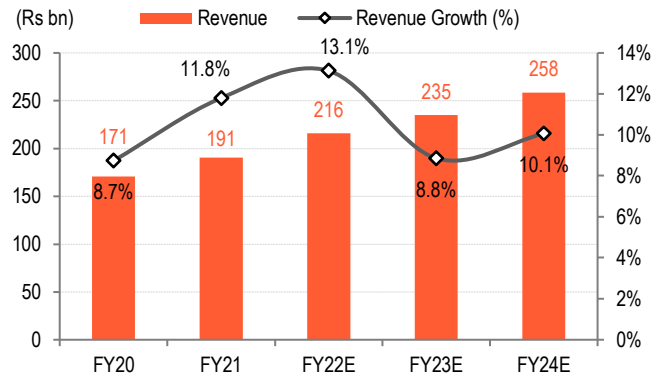
One-India strategy yielding fruit

Cipla's One-India strategy is demonstrating scale and continued momentum across its three domestic divisions of prescription, trade generics and consumer health. The company is now the third largest player in India in therapies such as respiratory, urology and antivirals, and among the top 2 in the overall chronic business. As many as 11 of Cipla's brands are among the top 100, including Foracort, Actemra, Aerocort, Azee, Cipremi, and Seroflo, outpacing market growth. The company is also expanding access to high-quality and life-saving medicines through partnership agreements.

Leadership in respiratory therapies

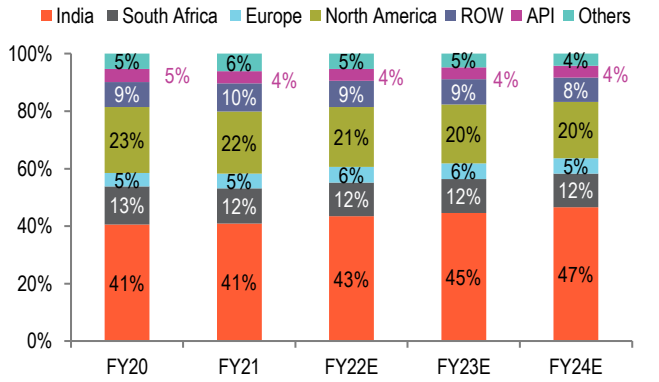
Cipla is second-largest inhaler selling company globally (MDI and DPI inhaler devices), as per IQVIA MAT Mar'21. In India, it commands 22% market share in respiratory therapies and 7 of its brands feature amongst the top 10 respiratory brands by value. The launch of Albuterol HFA in the US was a significant step towards the company's goal of achieving leadership in the respiratory space. As per IQVIA, Cipla now commands a dominant market share of 87% in gProventil, 16.5% in generic Albuterol HFA and 13.2% in the overall Albuterol HFA market.

Fig 1 – Revenue growth



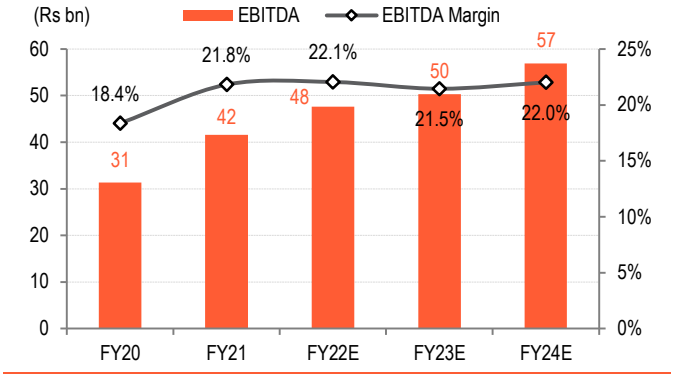
Source: Company, BOBCAPS Research

Fig 2 – Revenue breakup by geography



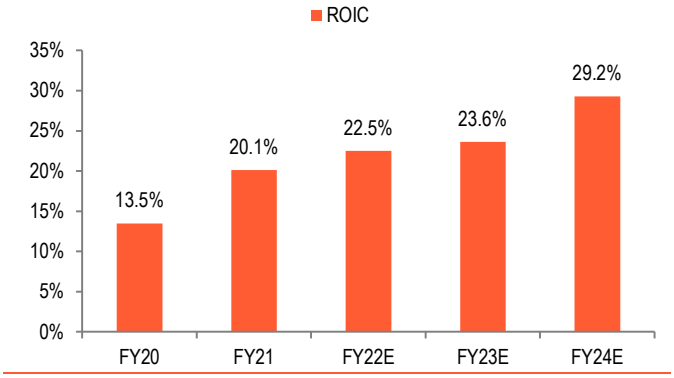
Source: Company, BOBCAPS Research

Fig 3 – EBITDA growth



Source: Company, BOBCAPS Research

Fig 4 – ROIC on an improving trend



Source: Company, BOBCAPS Research

Valuation methodology

We like Cipla for its strong India franchise, rich US pipeline and low risk of price erosion in the US market (top 3 products form 25% of US sales). Operating leverage in the US business is likely to be a key margin driver over FY22-FY24. We believe Cipla's future investments will have a sharper focus on opportunities in high-value/complex assets, but not at the expense of margins. The company continues to strengthen its revenue streams with a differentiated portfolio, product development capabilities and derisking of the supply chain across its markets.

As per management, Cipla's near-term priorities include continued execution on demand levers, improvement in manpower productivity, active advancement on innovative consumer-centric products to accelerate its global consumer wellness franchise, sustained leadership and growth in respiratory categories such as Albuterol, monitoring of key filings and acceleration of its global lung leadership aspirations, and maximising the value opportunity in US complex generics with steady launches.

We reiterate BUY and retain our TP at Rs 1,160 based on 16x FY24E EV/EBITDA (implied P/E of 26x). Our target multiple is at the midpoint of the stock's 10-year historical band (12-22x).

Fig 5 – Key assumptions

Revenue (Rs bn)	FY21	FY22E	FY23E	FY24E
India	77.4	92.8	104.0	77.4
North America	40.8	44.5	47.6	40.8
SAGA	34.5	36.4	38.3	34.5
International	28.3	31.2	33.4	28.3
API	8.0	8.8	9.7	8.0
OOI	1.7	2.0	1.9	1.7

Source: Company, BOBCAPS Research

Fig 6 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY21-24E (%)	EV/EBITDA (x)		ROE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Aurobindo	ARBP IN	BUY	850	6.9	6.7	5.7	13.3	13.9	7.5
Cipla	CIPLA IN	BUY	1,160	11.0	14.6	12.9	13.6	14.5	16.0
Dr. Reddy's	DRRD IN	HOLD	4,700	10.6	11.7	11.1	17.2	15.5	12.5
Sun Pharma	SUNP IN	BUY	1,045	14.9	16.3	14.6	16.1	16.1	18.0

Source: BOBCAPS Research

Key risks

- **Poor US execution:** We expect the US market to contribute meaningfully to profitability going forward. Any delay in ramp-up of key launches such as Advair Diskus can potentially erode earnings estimates.
- **Reduction in Global Access funding:** A decline in the tender-facing Global Access business due to challenges in the funding environment would pose a risk to our estimates.

- **Regulatory issues:** Failure to get clearance on plants under USFDA observations would affect growth.
- **Drug prices:** Weak drug price hikes in South Africa are another key downside risk to our estimates.

Sector recommendation snapshot

Company	Ticker	Market Cap (US$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.3	2,031	2,655	BUY
Alembic Pharma	ALPM IN	1.9	737	905	BUY
Alkem Labs	ALKEM IN	5.3	3,365	4,000	HOLD
Aurobindo Pharma	ARBP IN	5.3	680	850	BUY
Cipla	CIPLA IN	10.2	955	1,160	BUY
Divi's Labs	DIVI IN	15.0	4,278	5,250	BUY
Dr Reddy's Labs	DRRD IN	9.2	4,205	4,700	HOLD
Eris Lifesciences	ERIS IN	1.3	696	890	BUY
Laurus Labs	LAURUS IN	3.8	528	570	HOLD
Sun Pharma	SUNP IN	27.5	865	1,045	BUY

Source: BOBCAPS Research, NSE | Price as of 14 Feb 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	**1,70,577**	**1,90,682**	**2,15,698**	**2,34,785**	**2,58,411**
EBITDA	31,317	41,611	47,567	50,362	56,938
Depreciation	11,760	10,677	13,195	13,867	14,539
EBIT	19,557	30,934	34,371	36,494	42,399
Net interest inc./(exp.)	(1,972)	(1,607)	(625)	(390)	(244)
Other inc./(exp.)	3,442	2,660	3,810	4,397	6,822
Exceptional items	0	0	0	0	0
EBT	21,027	31,987	37,557	40,501	48,977
Income taxes	6,312	8,888	9,952	10,733	12,979
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	5	(36)	0	0	0
Reported net profit	**14,710**	**23,135**	**27,604**	**29,768**	**35,998**
Adjustments	0	0	0	0	0
Adjusted net profit	**14,710**	**23,135**	**27,604**	**29,768**	**35,998**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	22,818	20,668	29,272	31,909	35,113
Other current liabilities	10,604	14,709	12,821	13,976	15,380
Provisions	10,815	11,945	13,507	14,724	16,202
Debt funds	28,160	15,375	9,609	6,006	3,754
Other liabilities	0	0	0	0	0
Equity capital	1,613	1,613	1,613	1,613	1,613
Reserves & surplus	1,60,215	1,84,062	2,07,634	2,33,370	2,65,336
Shareholders' fund	1,61,827	1,85,675	2,09,247	2,34,983	2,66,949
Total liab. and equities	**2,34,224**	**2,48,372**	**2,74,456**	**3,01,597**	**3,37,398**
Cash and cash eq.	10,039	14,012	20,536	47,487	81,876
Accounts receivables	38,910	34,457	43,908	47,863	52,670
Inventories	43,776	46,692	58,543	63,818	70,227
Other current assets	21,715	21,267	29,916	32,611	35,886
Investments	15,953	28,318	28,318	28,318	28,318
Net fixed assets	51,281	49,563	44,367	38,500	31,960
CWIP	8,245	9,689	9,689	9,689	9,689
Intangible assets	44,305	44,375	39,180	33,312	26,773
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	**2,34,224**	**2,48,372**	**2,74,456**	**3,01,597**	**3,37,398**

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	**33,111**	**40,491**	**19,750**	**37,110**	**42,378**
Capital expenditures	(9,259)	(7,180)	(8,000)	(8,000)	(8,000)
Change in investments	9,586	(12,365)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	**327**	**(19,545)**	**(8,000)**	**(8,000)**	**(8,000)**
Equities issued/Others	1	0	0	0	0
Debt raised/repaid	(15,001)	(12,785)	(5,766)	(3,603)	(2,252)
Interest expenses	(1,972)	(1,607)	(625)	(390)	(244)
Dividends paid	(2,419)	(4,032)	(4,032)	(4,032)	(4,032)
Other financing cash flows	(10,198)	1,452	5,195	5,867	6,539
Cash flow from financing	**(29,589)**	**(16,972)**	**(5,227)**	**(2,159)**	**11**
Chg in cash & cash eq.	**3,850**	**3,974**	**6,523**	**26,951**	**34,389**
Closing cash & cash eq.	**10,038**	**14,013**	**20,536**	**47,487**	**81,876**

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	18.3	28.7	34.3	36.9	44.7
Adjusted EPS	18.3	28.7	34.3	36.9	44.7
Dividend per share	3.0	5.0	5.0	5.0	5.0
Book value per share	197.1	227.1	256.3	288.2	327.9

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	4.6	4.1	3.5	3.2	2.8
EV/EBITDA	25.1	18.8	16.0	14.7	12.7
Adjusted P/E	52.3	33.3	27.9	25.8	21.4
P/BV	4.8	4.2	3.7	3.3	2.9

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	70.0	72.3	73.5	73.5	73.5
Interest burden (PBT/EBIT)	107.5	103.4	109.3	111.0	115.5
EBIT margin (EBIT/Revenue)	11.5	16.2	15.9	15.5	16.4
Asset turnover (Rev./Avg TA)	21.9	24.4	25.7	25.5	25.3
Leverage (Avg TA/Avg Equity)	1.2	1.1	1.1	1.0	1.0
Adjusted ROAE	9.5	13.5	14.2	13.6	14.5

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	8.7	11.8	13.1	8.8	10.1
EBITDA	29.3	32.9	14.3	5.9	13.1
Adjusted EPS	120.3	57.3	19.3	7.8	20.9
Profitability & Return ratios (%)					
EBITDA margin	18.4	21.8	22.1	21.5	22.0
EBIT margin	11.5	16.2	15.9	15.5	16.4
Adjusted profit margin	8.6	12.1	12.8	12.7	13.9
Adjusted ROAE	9.5	13.5	14.2	13.6	14.5
ROCE	11.8	17.2	18.2	17.8	19.2
Working capital days (days)					
Receivables	85	67	75	75	75
Inventory	96	90	100	100	100
Payables	50	40	50	50	50
Ratios (x)					
Gross asset turnover	1.2	1.2	1.3	1.4	1.5
Current ratio	2.6	2.5	2.8	3.2	3.6
Net interest coverage ratio	9.9	19.2	55.0	93.5	173.8
Adjusted debt/equity	0.1	(0.1)	(0.2)	(0.3)	(0.4)

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

HOLD
TP: Rs 570 | ⮝ 8%

LAURUS LABS

| Pharmaceuticals | 15 February 2022

New capex to derisk revenue from HIV tender business

- **Diversification into high-margin finished dosage forms and CDMO plus focus on non-ARV API to improve quality of revenue and earnings**
- **Capacity addition capex of Rs 15bn-17bn over FY22-FY24 to gradually bolster earnings visibility**
- **We maintain HOLD with an unchanged TP of Rs 570 based on 17x FY24E EV/EBITDA**

Surajit Pal | Saad Shaikh
researchreport@bobcaps.in

Global leader in ARV APIs: Laurus is a leading manufacturer globally of select APIs, including molecules in ARV, Hepatitis C, and oncology therapeutic areas. The company is the preferred API supplier for global ARV majors, has a large manufacturing capacity and economies of scale, with ARVs contributing two-third of its revenues. Following the approval for new TLD drugs, Laurus plans to initiate a aggressive strategy to capture major market share in the tender business by FY24.

To be hardest hit in event of HIV vaccine success: With Moderna's ongoing trials for an mRNA HIV vaccine, the technological contribution of a global network of labs and their accumulated knowledge from all failed trials since the 80s, as well as monetary support from large multilateral organisations/charities, we see a high probability of a successful vaccine emerging for HIV patients. It may initially be a prophylactic for non-HIV patients and gradually expand to existing patients. This would lead to a potential threat for ARV manufacturers and Laurus in particular in terms of the formulation and API sales of its global portfolio.

Expanding capacity in non-ARV products to derisk business model: ARV APIs and formulations have been growth drivers for Laurus since its inception. The company is, however, investing capex to evolve faster in the non-ARV segment. It has ramped up capabilities in custom synthesis (11% of sales in FY21) and forayed into the biotech business through the acquisition of Richcore and a stake purchase in CAR-T therapy (26% stake in Immunoadoptive Cell Therapy).

Maintain HOLD; TP Rs 570: Given high industry-wide channel inventory and slower demand for ARV formulations and APIs, we have HOLD rating on the stock with a TP of Rs 570 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 528
Market cap	US$ 3.8bn
Free float	74%
3M ADV	US$ 19.8mn
52wk high/low	Rs 724/Rs 334
Promoter/FPI/DII	27%/23%/5%

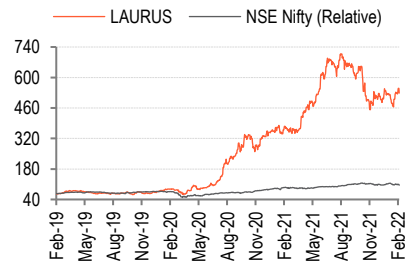
Source: NSE | Price as of 14 Feb 2022

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)	29.3	36.5	31.5
EV/EBITDA (x)	19.2	21.9	18.9
Adj. EPS growth (%)	276.6	(19.6)	15.8

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

Other business highlights

Faster execution and resource optimisation key for growth

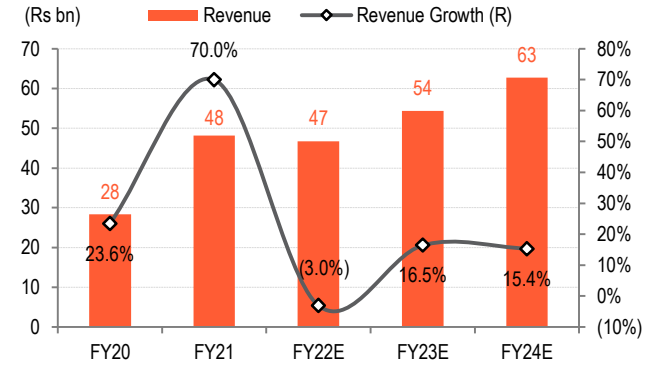
With a sustainable capex programme and strong order book, we expect a 9% sales CAGR and 7% EBITDA CAGR for Laurus over FY21-FY24.

Moreover, there has been a high inventory build-up with channel partners due to larger purchases by major buyers and tender agencies amid global trade and logistical uncertainty. This caused a slowdown in ARV sales in 9MFY22 which may continue to impact earnings in FY22 and partially in FY23.

Capex outlay of Rs 15bn-17bn over FY22-FY23 for new capacity

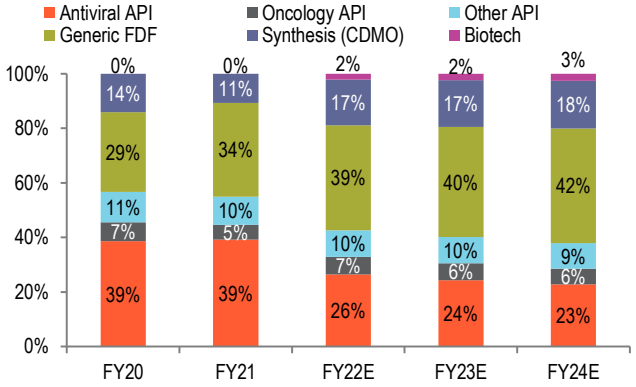
Laurus has increased its planned capex to Rs 15bn-17bn for FY22 and FY23 combined from Rs 12bn in FY21. Of this, 50% is for API capacity expansion, while the rest will be spent on formulations, custom synthesis and the bio division. In Q1FY22, the company added 1bn tab/caps of fixed dosage capacity (to 6bn tabs/caps) and expects 10bn tabs/ caps and reactor capacity of 5,638KL by end-FY22. ARV sales (API and FDF) stood at Rs 32.3bn (67% revenue share) and EBITDA at Rs 7.1bn (46% EBITDA share) in FY21, but remain at risk in the medium term as potential HIV vaccine development may disrupt growth.

Fig 1 – Expect revenue CAGR of 12% over FY21-FY24E



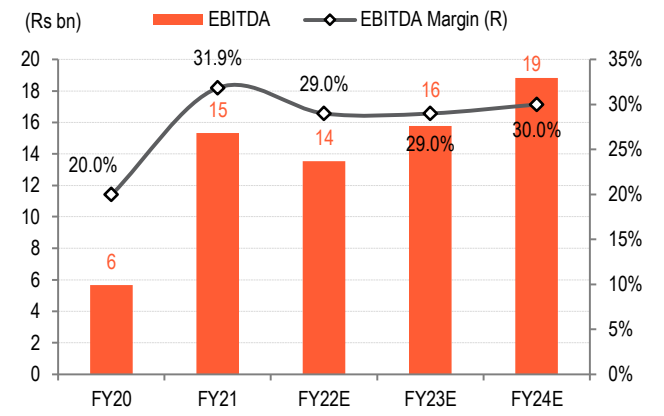
Source: Company, BOBCAPS Research

Fig 2 – Rising revenue from formulations, synthesis



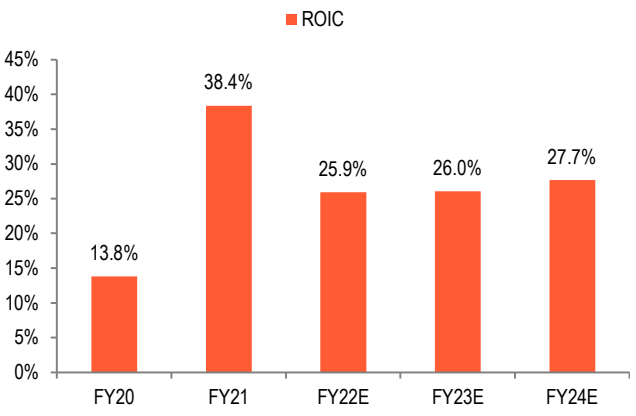
Source: Company, BOBCAPS Research

Fig 3 – Improved EBITDA margin profile



Source: Company, BOBCAPS Research

Fig 4 – ROIC to stabilise in the range of 31-32%



Source: Company, BOBCAPS Research

Valuation methodology

Given high industry-wide channel inventory and slower demand for ARV formulations and APIs, we have HOLD rating on the stock with a TP of Rs 570 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.

Fig 5 – Key assumptions

Revenue (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 6 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY21-24E (%)	EV/EBITDA (x)		ROE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
DIVI	DIVI IN	BUY	5,250	17.7	25.5	21.9	26.2	26.1	27.0
LAURUS	LAURUS IN	HOLD	570	6.8	18.6	15.7	24.5	23.8	17.0

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- **Higher concentration and pricing pressure in ARVs:** With strong revenue growth in the non-ARV portfolio due to the one-off, uncertain pandemic scenario, Laurus's ARV portfolio accounted for just 39% of revenues in FY21 (vs. 61% in FY19). Its ARV products (mainly TLE) had witnessed high pricing pressure in FY19 and FY20 due to a shift in tender business in favour of triple combination drug TLD. Laurus got delayed approval from the USFDA for its TLD application and plans to foray into the segment in FY22, inducing price competition with existing players.

  A shift in the treatment regime from Efavirenz to Dolutegravir has adversely impacted gross margins. To arrest the margin compression and business decline in ARVs, 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 may result in mitigating profitability risk in the medium term.

- **Regulatory risks in Unit 1 and 2 due to revenue concentration:** Laurus's Units 1 and 3 are critical as they account for 80% of current revenues (mainly catering to the API and synthesis businesses). Unit 2 is Laurus's 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 hence our forecast for the formulations business.

Sector recommendation snapshot

Company	Ticker	Market Cap (US$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.3	2,031	2,655	BUY
Alembic Pharma	ALPM IN	1.9	737	905	BUY
Alkem Labs	ALKEM IN	5.3	3,365	4,000	HOLD
Aurobindo Pharma	ARBP IN	5.3	680	850	BUY
Cipla	CIPLA IN	10.2	955	1,160	BUY
Divi's Labs	DIVI IN	15.0	4,278	5,250	BUY
Dr Reddy's Labs	DRRD IN	9.2	4,205	4,700	HOLD
Eris Lifesciences	ERIS IN	1.3	696	890	BUY
Laurus Labs	LAURUS IN	3.8	528	570	HOLD
Sun Pharma	SUNP IN	27.5	865	1,045	BUY

Source: BOBCAPS Research, NSE | Price as of 14 Feb 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	10.4	6.1	6.4	5.5	4.7
EV/EBITDA	52.0	19.2	21.9	18.9	15.8
Adjusted P/E	110.5	29.3	36.5	31.5	26.1
P/BV	16.0	10.9	8.7	7.0	5.6

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%

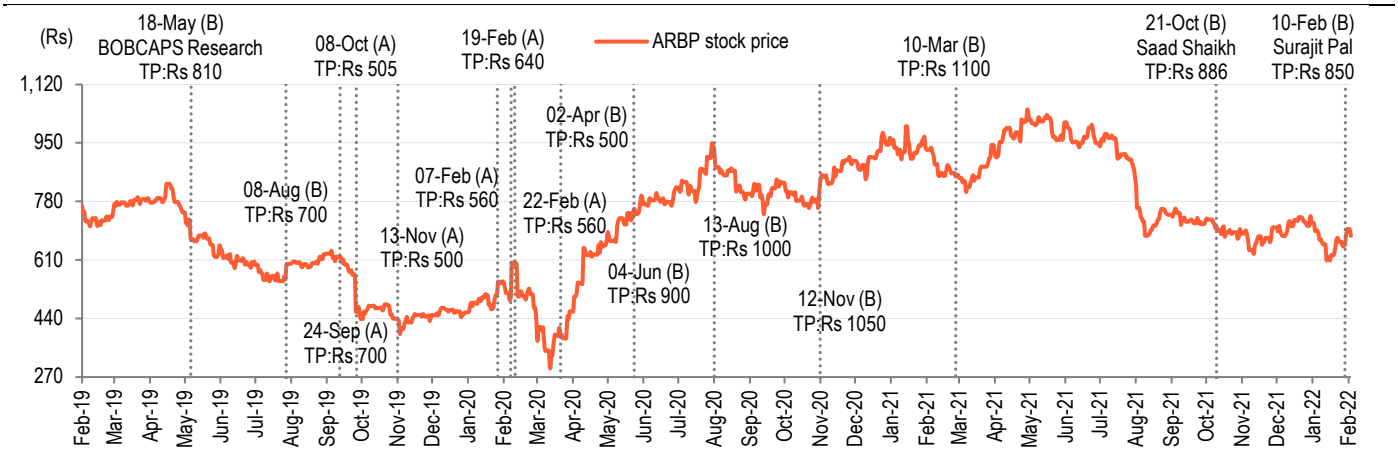
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

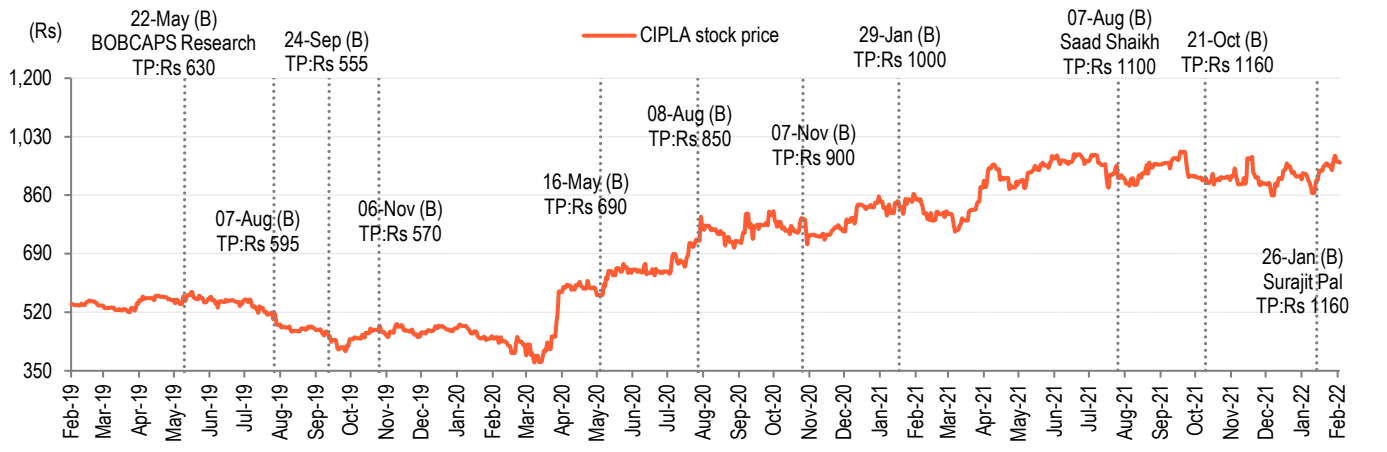
Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): AUROBINDO PHARMA (ARBP IN)



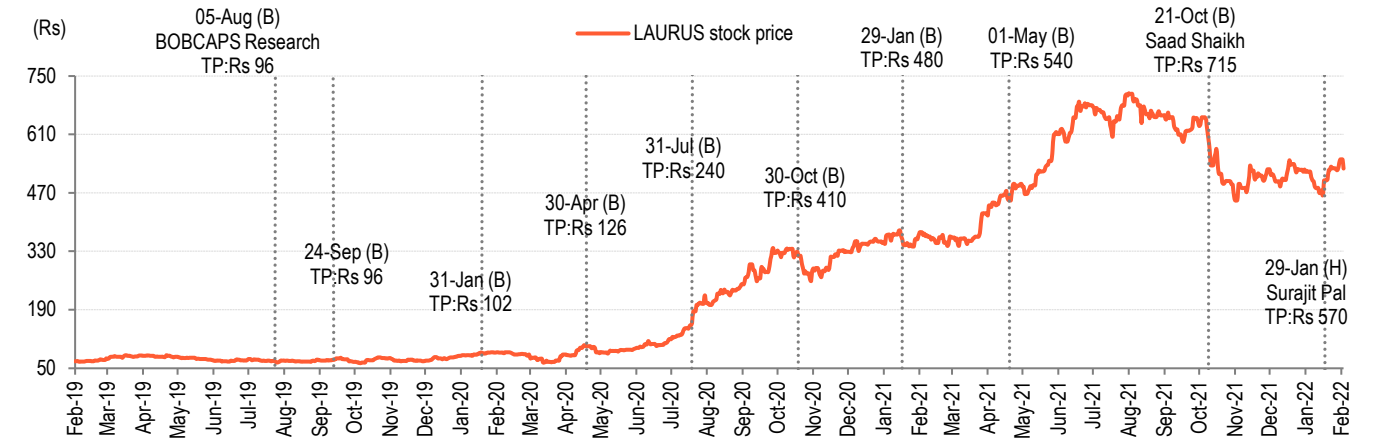
B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

Ratings and Target Price (3-year history): CIPLA (CIPLA IN)



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

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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