

BUY

TP: Rs 495 | ▲ 32%

LAURUS LABS

Pharmaceuticals

10 January 2019

On track for strong growth; retain BUY on positive risk-reward

We met Dr. Satyanarayana Chava (CMD) and Mr. Ravi Kumar (CFO) along with the Laurus IR team. Their views reinforce our expectations of a strong operating performance from the company over the next two years.

Management upbeat on growth: Management expects positive news flow on launches over the next 12-18 months and also visible operating leverage in its formulations segment. Further, any decline in Efavirenz (EFA) sales would be sufficiently mitigated by ramp-up in Lamivudine and Dolutegravir (DTG), as and when the market shifts. The company believes the worst of pricing pressure on the ARV portfolio and China-related cost inflation is behind us.

ARV guided to grow in mid-single digits, synthesis at 30% CAGR: ARV funding remains adequate and franchise revenues are guided to grow in mid-single digits annually. Laurus has participated in the ARV tenders in South Africa (2019-22) via a partner and remains hopeful of allocation in the near term. Management expects the synthesis business to log a >30% CAGR in FY19-FY21.

Lamivudine commercial launch planned for Feb'19: Exhibit batches to customers are in progress and most customer contracts are in place. Laurus continues to expect 30% market share by FY21 (we assume 20-22% share).

Well prepared for market shift to DTG: Laurus has already converted capacity for a few EFA intermediates into DTG which can be further augmented at minimal cost. The company is targeting annual capacity of 40-50tonnes depending on the market shift. Plant economics will be largely similar given that DTG is 1/12th in volumes and is priced 12x higher to EFA.

Import cost risk has materially reduced: Vertical integration of Tenofovir and Entricitabine to N-3 intermediates stage has lowered the risk from rising import costs, which had eroded H1FY19 gross margins.

No greenfield investment in next five years: From FY20, capex will reduce to Rs 1.5bn annually (vs. a Rs 3bn run-rate seen in each of the last three years). This should bolster free cash flows.

Retain BUY with 32% upside potential: In our view, the market is disregarding investments and potential upsides in formulations, even as resurgent FCF and ROCE would support valuations. Retain BUY with a Mar'20 target of Rs 495.

BOBCAPS Research

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Ticker/Price	LAURUS IN/Rs 375
Market cap	US\$ 565.5mn
Shares o/s	106mn
3M ADV	US\$ 0.2mn
52wk high/low	Rs 560/Rs 330
Promoter/FPI/DII	33%/9%/39%

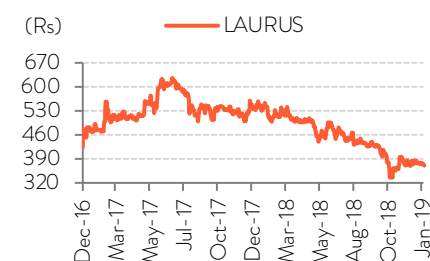
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	849	1,239	2,610
Adj. EPS (Rs)	8.0	11.6	24.5
Adj. EPS growth (%)	(42.8)	46.0	110.6
Adj. ROAE (%)	5.6	7.7	14.7
Adj. P/E (x)	47.0	32.2	15.3
EV/EBITDA (x)	14.0	11.9	8.1

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

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

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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INDUSTRY PHARMA
CMP (as on 01 Feb 2019) Rs 354
Target Price Rs 480

Nifty	10,894
Sensex	36,469

KEY STOCK DATA

Bloomberg	LAURUS IN
No. of Shares (mn)	106
MCap (Rs bn) / (\$ mn)	38/528
6m avg traded value (Rs mn)	36

STOCK PERFORMANCE (%)

52 Week high / low	Rs 550/330		
	3M	6M	12M
Absolute (%)	(0.8)	(22.6)	(31.7)
Relative (%)	(6.8)	(19.8)	(33.3)

SHAREHOLDING PATTERN (%)

Promoters	33.5
FIs & Local MFs	38.3
FPIs	8.1
Public & Others	20.1

Source : BSE

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High visibility on recovery

With three disappointing quarters behind, Laurus is finally likely to utilize its Formulations capacity with visibility on US\$ 35-40mn worth of orders for FY20. This will be attributed to contracts for a European CMO partner, US generic launches like Metformin and HCQ, and TLD supplies to Global Fund and Aspen. Some of this will be seen in the next quarter as well; which, along with orders worth Rs 400-500mn postponed from 3Q, will result in a bumper 4QFY19. We have kept our estimates unchanged. With utilization of the Formulations plant and growth in the profitable synthesis/oncology segments, we expect earnings to triple over FY19-21E (on a low base). Reiterate strong BUY with a TP of Rs 480 (18x Dec-20E EPS).

Postponement of ARV and Hep-C API orders to 4Q resulted into suboptimal operating margin in 3Q. Adjusted for a milestone payment, it was at 14.3%; down 95bps QoQ. Revenues grew 7.6% YoY to Rs 5.2bn, 5% below our estimates. PAT came in at Rs 178mn, up 10% QoQ. Adjusted for the one-off payment, it was down 77/769% YoY/QoQ.

Financial Summary

Year Ending March (Rs mn)	3QFY19	3QFY18	YoY (%)	2QFY19	QoQ (%)	FY18	FY19E	FY20E	FY21E
Net Sales	5,155	4,789	7.6	5,883	(12.4)	20,690	22,675	25,368	28,603
EBITDA	737	873	(15.6)	897	(17.8)	4,133	3,374	5,040	6,770
APAT	80	349	(77.0)	260	(69.2)	1,676	899	1,885	3,168
Diluted EPS (Rs)	0.8	3.3	(77.0)	2.4	(69.2)	15.8	8.4	17.7	29.8
P/E (x)						22.4	41.9	20.0	11.9
EV/EBITDA (x)						11.3	13.9	9.1	6.5
RoE (%)						11.9	4.6	11.5	16.9

Source: Company, HDFC sec Inst Research # Consolidated

Highlights of the quarter

- Formulations:** Laurus has commenced formulations supplies to a CMO partner in EU and is validating two more products for this partner, which should be commercialized in FY20. It has also started shipping Metformin to the US in 3Q, which will be recognized in the books in 4Q. Laurus currently has 3 approvals and expects 2 more in FY20.
- Tenders:** (1) Received USFDA approval for TLD, expecting WHO approval in Feb-19. (2) Filed TLE 600 in Oct-18 & TLE 400 in Jan-19 with the USFDA and WHO. Expect approvals within CY19. (3) Will be supplying TLD to Aspen for SA tenders.
- APIs:** (1) Will start commercial supplies from 3TC facility in 4Q. (2) Laurus has now completed validation of all 2L ARV APIs. (3) Received WHO DMF approval for DTG and 3TC. (4) Hep-C API biz will be back to 2Q levels (~Rs 240mn) next quarter. (5) Growth in Onco API biz was aided by expanded capacity and new products. Expect 3 more products and ~20% growth in FY20.
- Near-term outlook:** Expect stock to run-up post USFDA approval for TLD, which will enable tender wins.

Revenue growth was aided by Onco API and Synthesis segments

Gross margin remained subdued due to price hikes in key raw materials

Management has guided EBITDA margin to expand ~100bps in 4Q owing to commencement of backward integration for a key raw material

During the quarter, Laurus received US\$ 2mn in milestone payments from CASI Pharma

Tax rate should be at 27-28% going ahead

Quarterly Financial Snapshot (Consolidated)

Particulars (Rs mn)	3QFY19	3QFY18	YoY (%)	2QFY19	QoQ (%)
Net Sales	5,155	4,789	7.6	5,883	(12.4)
Material Expenses	2,839	2,458	15.5	3,146	(9.8)
Employee Expenses	689	647	6.5	735	(6.2)
Other Expenses	889	811	9.6	1,104	(19.5)
EBITDA	737	873	(15.6)	897	(17.8)
Depreciation	427	310		398	
EBIT	310	564	(45.0)	499	(37.9)
Other Income	14	99		105	
Interest Cost	237	178		246	
EO Items	140	-		(140)	
PBT	228	486	(53.1)	218	4.5
Tax	50	137		56	
RPAT	178	349	(48.9)	162	9.9
EO Items (Adj For Tax)	(98)	-		98	
APAT	80	349	(77.0)	260	(69.2)

Source: Company, HDFC sec Inst Research

Margin Analysis

	3QFY19	3QFY18	YoY (bps)	2QFY19	QoQ (bps)
Material Expenses % Net Sales	55.1	51.3	377	53.5	160
SG&A Expenses % Net Sales	13.4	13.5	(15)	12.5	88
Other Expenses % Net Sales	17.2	16.9	31	18.8	(153)
EBITDA Margin (%)	14.3	18.2	(394)	15.3	(95)
Tax Rate (%)	21.7	28.2	(644)	25.6	(387)
APAT Margin (%)	1.6	7.3	(573)	4.4	(287)

Source: Company, HDFC sec Inst Research

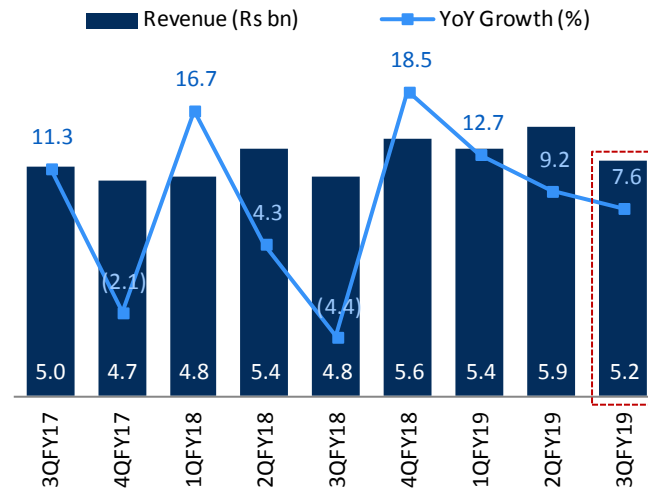
Postponement in ARV API orders led to sequential decline in revenues. This, along with 3TC (Lamivudine) supplies starting this quarter will result in a bumper 4Q for ARV APIs

4Q will also see normalization in the Hep-C API segment, which is expected to return to 2QFY19 levels (~Rs 240mn)

EBITDA margin is expected to recover in 4Q, aided by backward integration in a key raw material and uptick in the ARV & Hep-C API segments owing to orders postponed from 3Q

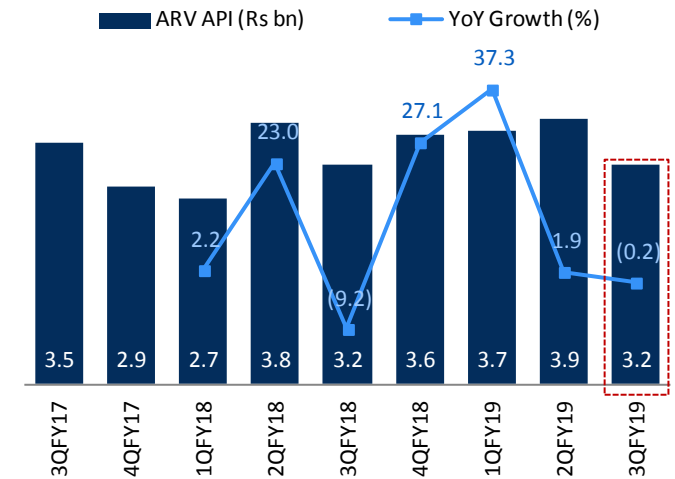
Laurus filed 2 ANDAs during the quarter and is on track to file ~10 ANDAs yearly

Revenue: YoY Growth Led By Onco APIs & Synthesis



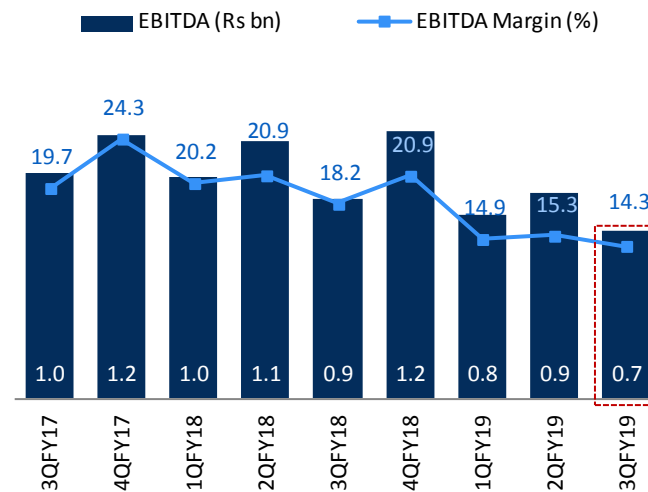
Source: Company, HDFC sec Inst Research

ARV API: Flat YoY Due To Postponement Of Orders



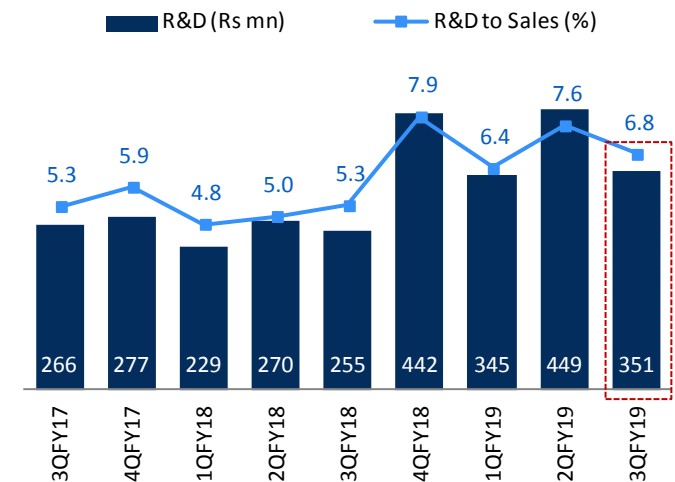
Source: Company, HDFC sec Inst Research

EBITDA Margin: Bottomed Out, Recovery Expected From 4Q



Source: Company, HDFC sec Inst Research

R&D: Reflecting Healthy Filings Rate



Source: Company, HDFC sec Inst Research

The formulations segment is expected to do better than earlier expected as Laurus has orders in hand for its EU CMO partner. Additionally, it will launch Metformin and other products in the US and globally

Uptick in the Synthesis segment was led by commencement of supplies from Unit 5 to Aspen and new orders from existing partners

Laurus has started commercial supplies to C2 Pharma. Unit 4 will further boost revenue growth in the Ingredients segment

The API segment will see a strong surge in 4Q with normalization in the Hep-C segment, postponed ARV API orders and traction gained in Onco APIs

Segmental Quarterly Performance

(Rs mn)	3QFY19	3QFY18	YoY (%)	2QFY19	QoQ (%)
ARV API	3,202	3,209	(0.2)	3,882	(17.5)
Hep-C API	197	239	(17.7)	344	(42.7)
Oncology API	569	431	32.0	465	22.4
Other API	489	431	13.4	533	(8.3)
Total API	4,457	4,310	3.4	5,224	(14.7)
Formulations	191	-	-	22	768.2
Synthesis	541	383	41.2	530	2.1
Ingredients	106	96	10.7	107	(0.9)
Total	5,295	4,789	10.6	5,883	(10.0)

Source: HDFC sec Inst Research

Assumptions

Key segments (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
ARV API	12,212	13,358	14,699	13,950	12,637
Growth (%)	(3.2)	9.4	10.0	(5.1)	(9.4)
Hep-C API	2,509	1,669	1,085	1,031	979
Growth (%)	27.3	(33.5)	(35.0)	(5.0)	(5.0)
Oncology API	1,073	1,623	1,915	2,183	2,489
Growth (%)	(24.1)	51.3	18.0	14.0	14.0
Other API	1,498	1,724	1,845	2,121	2,440
Growth (%)	191.8	15.1	7.0	15.0	15.0
Total API	17,292	18,374	19,543	19,285	18,544
Growth (%)	4.7	6.3	6.4	(1.3)	(3.8)
Formulations	-	18	483	2,800	6,120
Growth (%)	-	-	2,583.3	479.7	118.6
Synthesis	1,015	1,535	2,072	2,590	3,108
Growth (%)	21.5	51.2	35.0	25.0	20.0
Ingredients	612	607	577	692	830
Growth (%)	31.6	(0.8)	(5.0)	20.0	20.0
Total	18,919	20,534	22,675	25,368	28,603
Growth (%)	6.2	8.5	10.4	11.9	12.8

Source: HDFC sec Inst Research

Peer Set Comparison

	Mcap (Rs bn)	CMP (Rs/sh)	Reco	TP/FV	Adj EPS (Rs/sh)				P/E (x)				RoE (%)			
					FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E
Sun Pharma	1,015	423	BUY	660	13.0	16.4	21.9	27.9	32.6	25.8	19.3	15.2	8.3	9.9	12.2	13.9
Aurobindo Pharma	467	798	NEU	845	41.4	40.6	55.7	56.4	19.3	19.6	14.3	14.1	23.0	18.6	21.1	17.8
Dr Reddy's Labs	463	2,791	BUY	3,260	59.2	105.9	123.9	150.8	47.2	26.4	22.5	18.5	7.8	13.1	13.5	14.3
Cipla	420	521	BUY	605	18.6	17.5	22.4	29.2	28.1	29.9	23.3	17.8	11.2	9.5	11.1	13.1
Divi's Labs	407	1,532	SELL	1,395	32.4	51.0	56.8	65.7	47.3	30.0	27.0	23.3	15.2	21.1	20.3	20.4
Lupin	399	883	BUY	1,125	38.0	27.9	38.7	55.2	23.2	31.7	22.8	16.0	12.7	9.0	11.6	14.9
Cadila Healthcare	331	324	BUY	480	13.0	15.9	19.3	22.8	24.9	20.3	16.8	14.2	17.0	17.2	17.7	17.9
Torrent Pharma	304	1,799	NEU	1,860	40.1	45.9	63.6	91.7	44.9	39.2	28.3	19.6	15.1	15.8	19.1	23.4
Alkem Laboratories	226	1,888	BUY	2,400	57.6	71.8	90.0	115.6	32.8	26.3	21.0	16.3	14.8	16.5	18.1	20.0
Glenmark	187	662	BUY	835	17.5	27.0	35.2	46.4	37.9	24.5	18.8	14.3	9.4	12.8	14.7	16.9
Jubilant Life Sciences	114	714	BUY	1,070	45.5	58.6	64.9	80.0	15.7	12.2	11.0	8.9	19.3	20.7	19.2	19.9
Alembic Pharma	111	588	NEU	580	21.9	24.1	24.7	34.7	26.9	24.4	23.8	16.9	20.0	18.6	16.2	19.7
Strides Shasun	40	446	BUY	585	12.7	5.5	30.8	39.3	35.1	81.5	14.5	11.3	4.4	1.9	9.7	11.4
Laurus Labs	38	354	BUY	480	15.8	8.4	17.7	29.8	22.4	41.9	20.0	11.9	11.9	4.6	11.5	16.9
Dishman Carbogen Amcis	33	204	BUY	380	13.2	16.0	20.9	26.7	15.4	12.7	9.8	7.6	14.6	15.2	16.7	18.1
Suven Life Sciences	25	195	NR	450	9.7	8.9	10.8	12.3	20.1	22.0	18.1	15.9	17.2	13.9	14.9	15.1
Granules India	23	89	BUY	160	5.2	9.3	11.3	14.2	17.1	9.6	7.9	6.3	12.0	16.9	17.8	19.1
Neuland Labs	7	530	BUY	885	11.0	15.5	51.8	67.2	48.4	34.2	10.2	7.9	2.2	3.2	9.1	10.8

Source: HDFC sec Inst Research

Change In Estimates (Consolidated)

Rs mn	Previous			New			% Chg		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Net Sales	22,357	25,117	28,714	22,675	25,368	28,603	1.4	1.0	(0.4)
EBITDA	3,336	4,990	6,796	3,374	5,040	6,770	1.2	1.0	(0.4)
APAT	920	1,857	3,167	899	1,885	3,168	(2.3)	1.5	0.0

Source: HDFC sec Inst Research

Income Statement (Consolidated)

Year ending March (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Net Revenues	19,315	20,690	22,675	25,368	28,603
Growth (%)	6.7	7.1	9.6	11.9	12.8
Material Expenses	9,968	10,637	12,154	12,760	13,729
Employee Expenses	2,462	2,580	2,925	3,272	3,575
Selling and Administration Expenses	695	1,084	1,429	1,408	1,416
Other Operating Expenses	2,114	2,255	2,794	2,887	3,113
EBITDA	4,076	4,133	3,374	5,040	6,770
EBITDA Margin (%)	21.1	20.0	14.9	19.9	23.7
EBITDA Growth (%)	12.5	1.4	-18.4	49.4	34.3
Depreciation	1,060	1,255	1,643	1,825	1,976
EBIT	3,017	2,879	1,731	3,215	4,794
Other Income (Including EO Items)	334	292	180	250	350
Interest	999	796	940	882	803
PBT	2,352	2,374	971	2,582	4,340
Tax (Incl Deferred)	439	698	272	697	1,172
RPAT	1,913	1,676	699	1,885	3,168
Share of profit / (loss) from associate	(11)	-	-	-	-
RPAT after share of profit/(loss) from associate	1,903	1,676	699	1,885	3,168
EO (Loss) / Profit (Net Of Tax)	-	-	200	-	-
APAT	1,913	1,676	899	1,885	3,168
APAT Growth (%)	42.6	-12.4	-46.4	109.7	68.1
Adjusted EPS (Rs)	18.1	15.8	8.4	17.7	29.8

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

As at March (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
SOURCES OF FUNDS					
Share Capital - Equity	1,058	1,060	1,060	1,060	1,060
Reserves	12,247	13,766	14,423	16,195	19,174
Total Shareholders Funds	13,304	14,826	15,484	17,256	20,234
Long Term Debt	1,246	1,417	1,717	1,717	967
Short Term Debt	7,848	7,585	8,085	8,085	7,085
Total Debt	9,094	9,002	9,802	9,802	8,052
Net Deferred Taxes	(699)	(529)	(529)	(529)	(529)
Long Term Provisions & Others	722	855	760	760	760
TOTAL SOURCES OF FUNDS	22,422	24,155	25,516	27,289	28,517
APPLICATION OF FUNDS					
Net Block	12,202	14,711	15,568	15,492	15,266
CWIP	1,433	1,632	1,000	680	680
Goodwill	97	97	97	97	97
Investments	34	34	34	34	34
Other Non-current Assets	671	689	1,925	1,925	1,925
Total Non-current Assets	14,437	17,162	18,624	18,229	18,003
Inventories	5,090	5,848	5,827	6,118	6,583
Debtors	5,676	5,706	6,088	6,603	7,445
Other Current Assets	591	892	402	429	461
Cash & Equivalents	41	31	496	1,415	1,552
Total Current Assets	11,398	12,476	12,813	14,564	16,040
Creditors	2,631	3,123	3,330	3,146	3,385
Other Current Liabilities & Provns	782	2,360	2,591	2,358	2,141
Total Current Liabilities	3,413	5,484	5,921	5,504	5,526
Net Current Assets	7,985	6,992	6,892	9,060	10,514
TOTAL APPLICATION OF FUNDS	22,422	24,155	25,516	27,289	28,517

Source: Company, HDFC sec Inst Research

Cash Flow (Consolidated)

Year ending March (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Reported PBT	2,352	2,374	971	2,582	4,340
Non-operating & EO items	3	224	(180)	(250)	(350)
Interest expenses	931	761	940	882	803
Depreciation	1,060	1,255	1,643	1,825	1,976
Working Capital Change	(525)	(570)	(767)	(1,249)	(1,317)
Tax Paid	(501)	(619)	(272)	(697)	(1,172)
OPERATING CASH FLOW (a)	3,320	3,425	2,336	3,094	4,281
Capex	(2,775)	(3,911)	(1,868)	(1,430)	(1,750)
Free cash flow (FCF)	545	(486)	467	1,664	2,531
Investments	(234)	-	-	-	-
Non-operating Income	122	62	-	-	-
INVESTING CASH FLOW (b)	(2,887)	(3,849)	(1,868)	(1,430)	(1,750)
Debt Issuance/(Repaid)	(2,387)	1,372	800		(1,750)
Interest Expenses	(950)	(761)	(760)	(632)	(453)
FCFE	(2,904)	186	507	1,032	327
Share Capital Issuance	2,860	3	(0)	(0)	0
Dividend	(59)	(191)	(42)	(113)	(190)
Others	-	-	-	-	-
FINANCING CASH FLOW (c)	(536)	422	(2)	(745)	(2,394)
NET CASH FLOW (a+b+c)	(103)	(2)	465	919	137

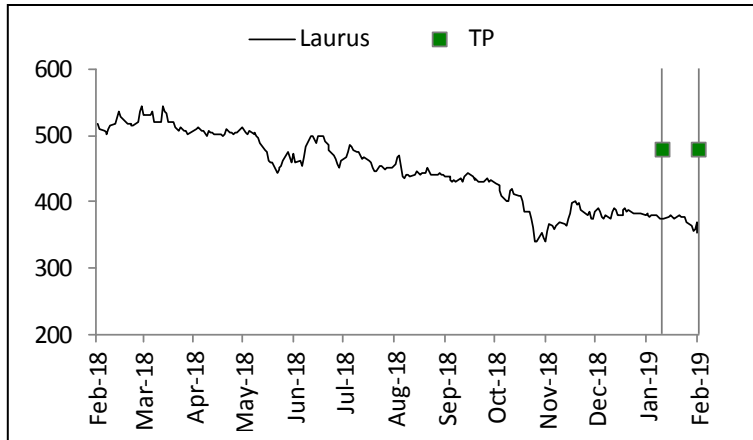
Source: Company, HDFC sec Inst Research

Key Ratios

	FY17	FY18	FY19E	FY20E	FY21E
PROFITABILITY (%)					
GPM	48.4	48.6	46.4	49.7	52.0
EBITDA Margin	21.1	20.0	14.9	19.9	23.7
APAT Margin	9.9	8.1	3.1	7.4	11.1
RoE	17.5	11.9	4.6	11.5	16.9
RoIC (or Core RoCE)	11.7	8.6	5.2	9.7	13.9
RoCE	12.8	9.4	5.4	9.4	13.2
EFFICIENCY					
Tax Rate (%)	18.7	29.4	28.0	27.0	27.0
Fixed Asset Turnover (x)	1.4	1.2	1.1	1.1	1.2
Inventory (days)	96.2	103.2	93.8	88.0	84.0
Debtors (days)	107.3	100.7	98.0	95.0	95.0
Other Current Assets (days)	9.3	15.6	2.8	2.5	2.2
Payables (days)	49.7	55.1	53.6	45.3	43.2
Other Current Liab & Provns (days)	12.9	40.9	37.5	30.2	24.0
Cash Conversion Cycle (days)	150.2	123.5	103.5	110.1	114.0
Debt/EBITDA (x)	2.2	2.2	2.9	1.9	1.2
Net D/E (x)	0.7	0.6	0.6	0.5	0.3
Interest Coverage (x)	3.0	3.6	1.8	3.6	6.0
PER SHARE DATA (Rs)					
EPS	18.1	15.8	8.4	17.7	29.8
Dividend	1.5	0.8	0.3	0.9	1.5
Book Value	125.8	139.8	145.5	162.1	190.1
VALUATION					
P/E (x)	19.6	22.4	41.9	20.0	11.9
P/BV (x)	2.8	2.5	2.4	2.2	1.9
EV/EBITDA (x)	11.4	11.3	13.9	9.1	6.5
EV/Revenues (x)	2.4	2.2	2.1	1.8	1.5
OCF/EV (%)	7.1	7.4	5.0	6.7	9.7
FCF/EV (%)	1.2	(1.0)	1.0	3.6	5.7
FCFE/Mkt Cap (%)	(7.8)	0.5	1.3	2.7	0.9
Dividend Yield (%)	0.4	0.2	0.1	0.3	0.4

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
10-Jan-19	372	BUY	480
3-Feb-19	354	BUY	480

Rating Definitions

- BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
- NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
- SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

INSTITUTIONAL RESEARCH
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