

INDUSTRY PHARMA

CMP (as on 27 Mar 2019) Rs 401

Target Price Rs 535

Nifty 11,445

Sensex 38,133

KEY STOCK DATA

Bloomberg LAURUS IN

No. of Shares (mn) 106

MCap (Rs bn) / (\$ mn) 43/618

6m avg traded value (Rs mn) 66

STOCK PERFORMANCE (%)

52 Week high / low Rs 520 / 321

3M 6M 12M

Absolute (%) 4.9 (7.1) (21.1)

Relative (%) (1.6) (12.1) (36.0)

SHAREHOLDING PATTERN (%)

Promoters 33.5

FIs & Local MFs 38.3

FPIs 8.1

Public & Others 20.1

Source : BSE

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Delivery has begun

Laurus has received Global Fund orders for the HIV drug, TLD, following a tentative approval from the US FDA last month. This is a big positive for the company and reinstates investor confidence in the business, with the formulations segment finally beginning to fire. With volume commitment for TLD from the Global Fund for the next 3.5 years, as well as ~US\$ 12-15mn orders in hand from an EU partner and ongoing supplies of Metformin and HCQ to the US, we have high visibility on ~US\$ 40mn formulations revenue in FY20E. This significant ramp up in formulations will drive opev and margin expansion.

Overall, we estimate 12/42/88% rev/EBITDA/earnings CAGR over FY19-21E. The stock is currently trading at attractive valuations of 22.6/13.5x FY20/21E EPS. We maintain BUY with a TP of Rs 535 (18x FY21E EPS). Refer our Jan-19 IC note for further details.

- **Global Fund partnership:** We believe TLD is a ~US\$ 300mn opportunity in the ARV (anti-retroviral) tender market and the Global Fund accounts for ~US\$ 130mn. The market is only likely to grow with a shift from traditional TLE/TEE to TLD. At present, there are only 3 players with US FDA approval for TLD and Laurus is one of them. With this agreement, Laurus has already started supplying TLD to the Global Fund and likely to reach double-digit market share by CY20.
- **Formulation segment begins to fire:** Laurus has invested Rs 4.5bn in setting up its formulation plant and ~Rs 1bn in R&D. The idle capacity and recurring

Rs 1bn opex has hurt return ratios over the last two years. With clear visibility on the formulations order book, we believe our FY19E estimate of US\$ 40mn is likely to be achieved comfortably. Aided by (1) higher market share in TLD, (2) new product approvals like TLE 400/600, (3) country-specific tender opportunities in ARV, (4) CMO deals for ROW markets and (5) a ramp up in the US business with more product launches, formulation revenues are likely to reach US\$ 85mn in FY21E.

- **Expect a blow-out 4QFY19E:** As was highlighted in our 3QFY19 result update, API orders worth Rs 400-500mn were postponed over from 3Q. Moreover, Laurus has already started Metformin (US) and TLD supplies which will bump up formulations revenue in 4Q. We believe this will result in a 9/18% YoY/QoQ jump in revenue (~Rs 6.1bn). Additionally, Laurus will benefit from backward integration which will enable ~300bps QoQ margin expansion (17.5%). PAT is expected to be over ~Rs 300mn (45% of FY19E).

Financial Summary

YE March (Rs mn)	FY18	FY19E	FY20E	FY21E
Net Sales	20,690	22,675	25,368	28,603
EBITDA	4,133	3,374	5,040	6,770
APAT	1,676	900	1,886	3,169
Diluted EPS (Rs)	15.8	8.5	17.7	29.8
P/E (x)	25.3	47.4	22.6	13.5
EV/EBITDA (x)	12.5	15.4	10.1	7.3
RoE (%)	11.9	4.6	11.5	16.9

Source: Company, HDFC sec Inst Research

As of CY17, there are 37mn people globally with HIV and only 59% of them are under treatment. Moreover, over 70% of the population is concentrated in GA-LMICs (Generic-Accessible Low & Middle Income Countries)

~75% of the people under treatment (ART) in GA LMICs were receiving first-line (1L) regimen. In 2018, the WHO updated 1L guidelines from TLE/TEE to TLD. This will enable a significant ramp up in TLD over the next 3 years

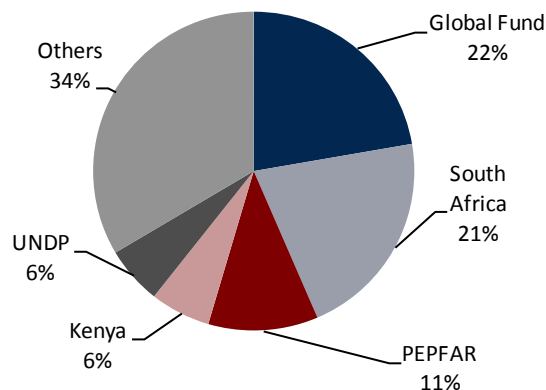
The ARV tender market in GA LMICs (~US\$ 1.8bn as of CY17) is highly concentrated within the top 3 donors – Global Fund, SA Govt Tenders, PEPFAR. The top 3 donors will allocate majority of their funds to TLE, TEE and TLD in CY19E

While prices of ARV drugs in GA LMICs decline YoY, patient coverage continues to increase. This will enable ~1.5% CAGR in the ARV tender market over CY17-22E

Potential opportunity for Laurus

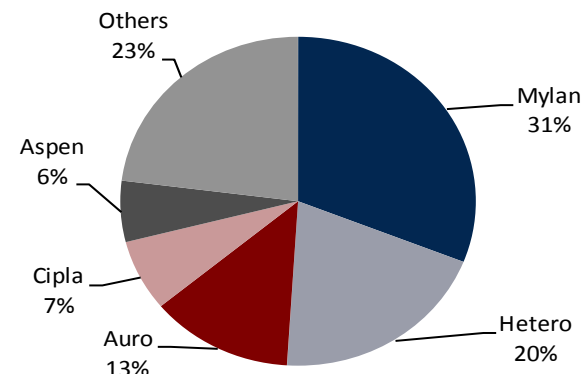
- Of the **US\$ 1.8bn (CY17) ARV tender market**, Laurus Labs is expected to get 10-20% market share in TLE, TEE and TLD by FY21-22E, with higher visibility in the top 3 donor funds.
- Laurus can compete in prices and still maintain margins by way of backward integration with its API manufacturing business. This is expected to yield a 25-27% EBITDA margin out of the ARV tender business.
- At peak potential, Laurus can generate US\$ 135mn revenue (at 15% market share of 3 products). A 27% margin would translate into EBITDA of US\$ 36mn from ARV formulations.

Fund-wise Contribution To ARV Tenders (CY19E)



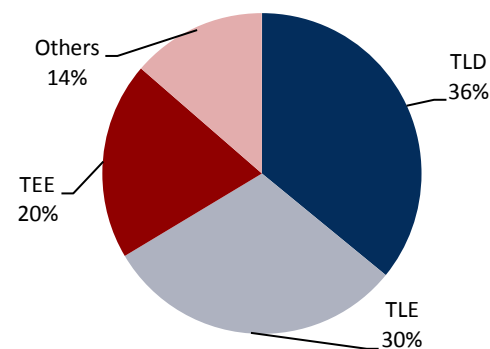
Source: Company, HDFC sec Inst Research

ARV Tender Market Share (CY17)



Source: Company, HDFC sec Inst Research

Product-wise Allocation By Top 3 Funds (CY19E)



Source: Company, HDFC sec Inst Research

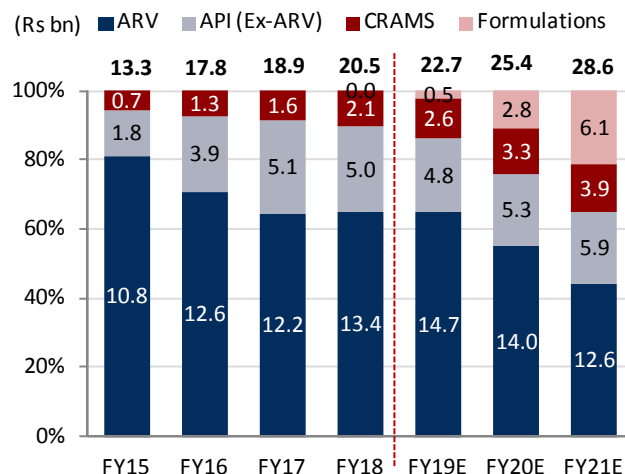
The formulations segment is going to be the new growth engine for Laurus while the synthesis and ingredients businesses are also expected to continue growing at double digits. Expect ~12% revenue CAGR over FY19-21E

Negative contribution of the formulations segment has been the key hurdle in EBITDA margin improvement. We believe Laurus' formulations segment will break-even by FY20E

The API and formulations facilities are operating at sub-optimal levels and have sufficient capacity to cater increase in demand over the near-term. Limited capex requirement will boost FCF which would be used to repay debt over the near-term

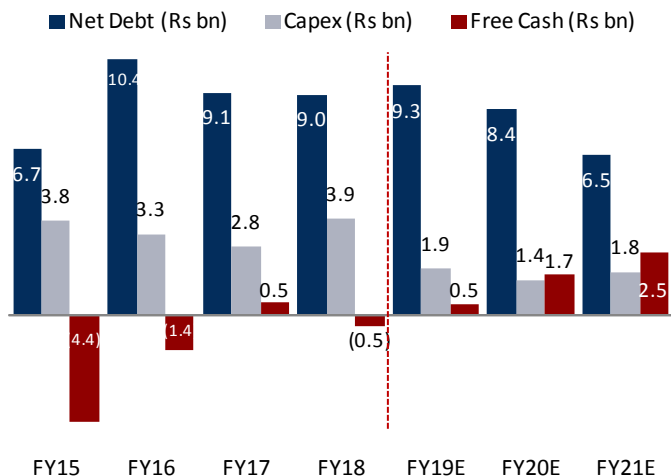
With higher asset turns and margins in the formulations segment, ROE/ROCE will be back to earlier levels of 17/13% by FY21E

Formulations Revenue Contribution To Increase



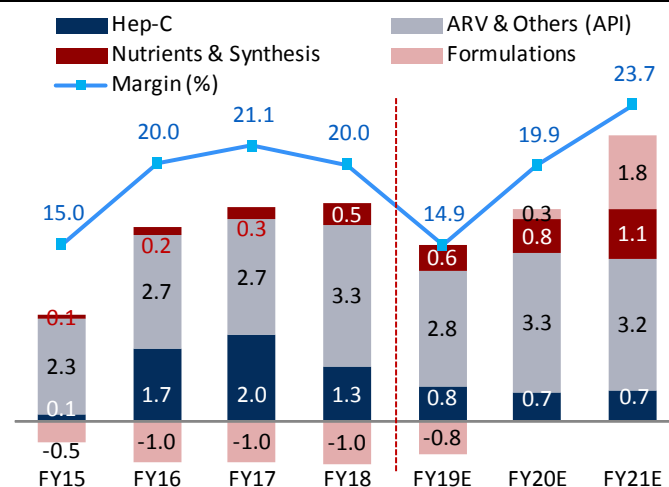
Source: Company, HDFC sec Inst Research

FCF To Improve, Coming Off Investment Cycle



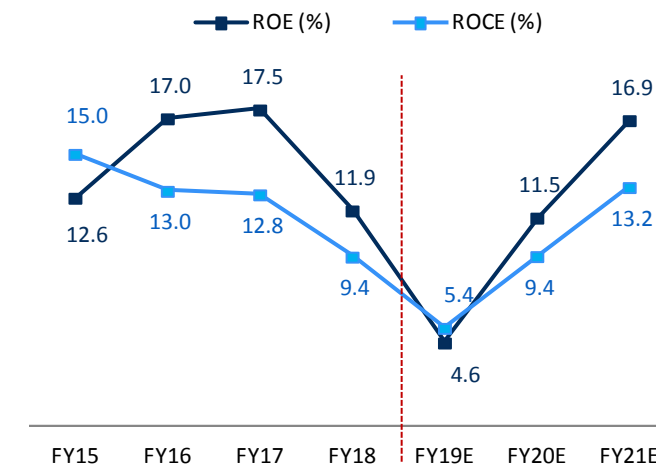
Source: Company, HDFC sec Inst Research

Segment-wise EBITDA Breakup (Rs bn)



Source: Company, HDFC sec Inst Research

Formulations To Drive Uptrend In Return Ratios



Source: Company, 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	1,115	465	BUY	605	13.0	15.7	20.8	27.3	35.8	29.7	22.4	17.0	8.3	9.6	11.7	13.7
Dr Reddy's Labs	459	2,765	BUY	3,260	59.2	105.9	123.9	150.8	46.7	26.1	22.3	18.3	7.8	13.1	13.6	14.3
Aurobindo Pharma	454	775	NEU	800	41.4	42.0	54.1	53.2	18.7	18.5	14.3	14.6	23.0	19.2	20.5	16.8
Divi's Labs	442	1,666	SELL	1,395	32.4	51.0	56.8	65.7	51.5	32.6	29.3	25.4	15.2	21.1	20.3	20.4
Cipla	423	526	BUY	605	18.6	15.9	21.2	28.7	28.3	33.1	24.7	18.3	11.2	8.7	10.7	13.0
Cadila Healthcare	338	330	BUY	465	13.0	14.8	17.5	21.7	25.4	22.3	18.8	15.2	17.0	16.0	16.4	17.5
Lupin	328	725	BUY	985	38.0	13.5	32.5	48.5	19.1	53.7	22.3	14.9	12.7	4.4	10.0	13.7
Torrent Pharma	319	1,886	NEU	1,860	40.1	45.9	63.6	91.7	47.1	41.1	29.6	20.6	15.1	15.8	19.1	23.4
Alkem Laboratories	209	1,750	BUY	2,340	57.6	63.7	86.6	113.1	30.4	27.5	20.2	15.5	14.8	14.8	17.7	19.9
Glenmark	181	641	BUY	800	17.5	27.0	34.2	43.9	36.7	23.7	18.7	14.6	9.4	12.7	14.1	15.8
Jubilant Life Sciences	104	653	BUY	1,070	45.5	58.6	64.9	80.0	14.3	11.1	10.1	8.2	19.3	20.7	19.2	19.9
Alembic Pharma	100	528	NEU	580	21.9	24.1	24.7	34.7	24.1	21.9	21.4	15.2	20.0	18.6	16.2	19.7
Laurus Labs	43	401	BUY	535	15.8	8.5	17.7	29.8	25.3	47.4	22.6	13.5	11.9	4.6	11.5	16.9
Strides Shasun	41	460	BUY	585	12.7	5.5	30.8	39.3	36.2	84.0	14.9	11.7	4.4	1.9	9.7	11.4
Suven Life Sciences	34	267	NR	450	9.7	5.6	9.8	11.3	27.5	47.8	27.2	23.7	17.2	8.9	14.2	14.5
Dishman Carbogen Amcis	33	207	BUY	380	13.2	16.0	20.9	26.7	15.6	12.9	9.9	7.7	14.6	15.2	16.7	18.1
Granules India	30	118	BUY	160	5.2	9.3	11.3	14.2	22.5	12.6	10.4	8.3	12.0	16.9	17.8	19.1
Neuland Labs	8	607	BUY	830	10.8	11.6	37.5	66.5	56.1	52.4	16.2	9.1	2.2	2.4	6.7	11.0

Source: Company, 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	1,642	1,824	1,975
EBIT	3,017	2,879	1,732	3,216	4,795
Other Income (Including EO Items)	334	292	180	250	350
Interest	999	796	940	882	803
PBT	2,352	2,374	972	2,583	4,341
Tax (Incl Deferred)	439	698	272	698	1,172
RPAT	1,913	1,676	700	1,886	3,169
Share of profit / (loss) from associate	(11)	-	-	-	-
RPAT after share of profit/(loss) from associate	1,903	1,676	700	1,886	3,169
EO (Loss) / Profit (Net Of Tax)			(200)		
APAT	1,913	1,676	900	1,886	3,169
APAT Growth (%)	42.6	-12.4	-46.3	109.6	68.0
Adjusted EPS (Rs)	18.1	15.8	8.5	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	14,424	16,197	19,176
Total Shareholders Funds	13,304	14,826	15,484	17,257	20,236
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	25,517	27,290	28,519
APPLICATION OF FUNDS					
Net Block	12,202	14,711	15,569	15,494	15,269
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	18,625	18,231	18,006
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	495	1,414	1,551
Total Current Assets	11,398	12,476	12,813	14,563	16,039
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	9,059	10,513
TOTAL APPLICATION OF FUNDS	22,422	24,155	25,517	27,290	28,519

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	972	2,583	4,341
Non-operating & EO items	3	224	(180)	(250)	(350)
Interest expenses	931	761	940	882	803
Depreciation	1,060	1,255	1,642	1,824	1,975
Working Capital Change	(525)	(570)	(767)	(1,249)	(1,317)
Tax Paid	(501)	(619)	(272)	(698)	(1,172)
OPERATING CASH FLOW (a)	3,320	3,425	2,335	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	(2,792)	124	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	918	137
EO Items, Equivalents	16	0			
Closing Cash & Equivalents	41	31	495	1,414	1,551

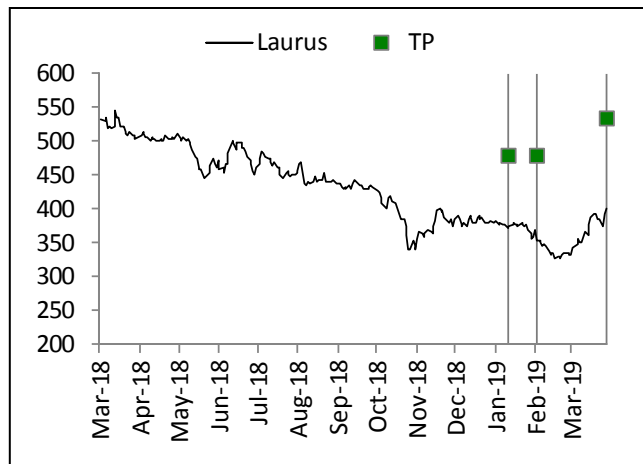
Source: Company, HDFC sec Inst Research

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	8.5	17.7	29.8
Dividend	1.5	1.5	0.3	0.9	1.5
Book Value	125.8	139.8	145.5	162.1	190.1
VALUATION					
P/E (x)	22.2	25.3	47.4	22.6	13.5
P/BV (x)	3.2	2.9	2.8	2.5	2.1
EV/EBITDA (x)	12.6	12.5	15.4	10.1	7.3
EV/Revenues (x)	2.7	2.5	2.3	2.0	1.7
OCF/EV (%)	6.5	6.7	4.5	6.1	8.7
FCF/EV (%)	1.1	(0.9)	0.9	3.3	5.1
FCFE/Mkt Cap (%)	(6.6)	0.3	1.2	2.4	0.8
Dividend Yield (%)	0.4	0.4	0.1	0.2	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
28-Mar-19	401	BUY	535

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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