



3R MATRIX

	+	=	-
Right Sector (RS)	✓	■	■
Right Quality (RQ)	✓	■	■
Right Valuation (RV)	✓	■	■

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	■	↔	■
RQ	■	↔	■
RV	■	↔	■

Reco/View

Change

Reco: Buy	↔
CMP: Rs. 337	
Price Target: Rs. 410	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

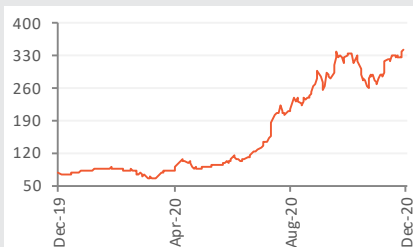
Company details

Market cap:	Rs. 18,087 cr
52-week high/low:	Rs. 366/62
NSE volume: (No of shares)	34.4 lakh
BSE code:	540222
NSE code:	LAURUSLABS
Free float: (No of shares)	36.4 cr

Shareholding (%)

Promoters	32.1
FII	22.8
DII	6.3
Others	38.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	19.4	18.6	192.7	340.8
Relative to Sensex	14.5	-3.4	160.9	330.4

Sharekhan Research, Bloomberg

Summary

- We retain a Buy recommendation on Laurus Labs Limited (Laurus) with a revised PT of Rs. 410.
- Formulations business gaining traction with tender business witnessing sturdy demand traction.
- Custom synthesis business is also expected to clock double-digit growth over FY2020-FY2023 backed by expanded capacities and increasing commencement of commercial supplies.
- Further, the company's foray in the lucrative biologics/biotech space through the acquisition of a majority stake in Richcore Lifesciences would be a key positive as it would create a new revenue stream.

We interacted with the management of Laurus Labs Limited (Laurus) and their commentary suggests a robust growth outlook. Laurus' formulations business is gaining traction with the tender business, which accounts for around three-fourth of total formulation sales, is witnessing sturdy growth. Moreover, Laurus is expanding capacities, primarily through brownfield expansions to cater to increasing demand. The first leg of de-bottlenecking is expected to be completed by Q4FY2021-end, while the second leg would be completed in two phases by September 2021 and December 2021. Cumulatively, the formulations capacity would increase by 80% in the next two years. Further, given strong demand traction, the formulations segment's performance in H2FY2021 is expected to be better than H1FY2021. The custom synthesis business is also expected to clock double-digit growth over FY2020-FY2023 backed by expanded capacities coming on stream during FY2022 and an increase in commencement of commercial supplies. Further, the recent acquisition of Richcore Lifesciences Pvt Limited (RLPL) is expected to yield synergies, though the benefits would accrue over the medium to long term. RLPL is implementing a capacity expansion plan, wherein it is expanding its fermentation capacities entailing an investment of Rs. 90 crore. Expanded capacities are likely to be ready by the end of FY2021 and are pre-booked by existing customers. The company is expecting an asset turnover of ~1.5x with revenues spread over FY22 and FY23. The above positives point to a strong growth trajectory for Laurus going ahead. We expect the company to report a sales and adjusted profit CAGR of 27% and 59%, respectively, over FY2020-FY2023.

Our Call

Retain Buy with revised PT of Rs.410: Laurus' formulations segment is witnessing elevated traction and the management expects to sustain the strong growth momentum going ahead. The tender business, which accounts for three-fourths of the overall segment revenues is on a strong footing and would be a key growth driver. Consequently performance of the formulations segment in H2FY2021 is expected to be better than that in H1FY2021. In addition to this, the custom synthesis business is also expected to clock double-digit growth over FY20 – FY23 driven by capacity expansion and rise in commencement of commercial supplies of products. Further, the company's foray in the lucrative biologics/biotech space through the acquisition of a majority stake in RLPL would be a key positive as it would create a new revenue stream for Laurus, though the benefits would accrue over the medium to long term. Strong topline growth and margin expansion (due to favorable mix) would result in a sturdy 59% earnings CAGR over FY2020 to FY2023. At the CMP, the stock is trading at a valuation of 21.7x/17.5x its FY2022E/FY2023E EPS. Sturdy growth prospects, visibility on earnings, healthy return ratios and low debt-equity are the key positives and this bodes well from a growth perspective. We retain a Buy recommendation on the stock with a revised PT of Rs. 410.

Key risk

Deferral in product approvals or any negative outcome of facility inspection by regulators can affect earnings prospects. Delay in approvals for closing RLPL deal could also slow down earnings growth.

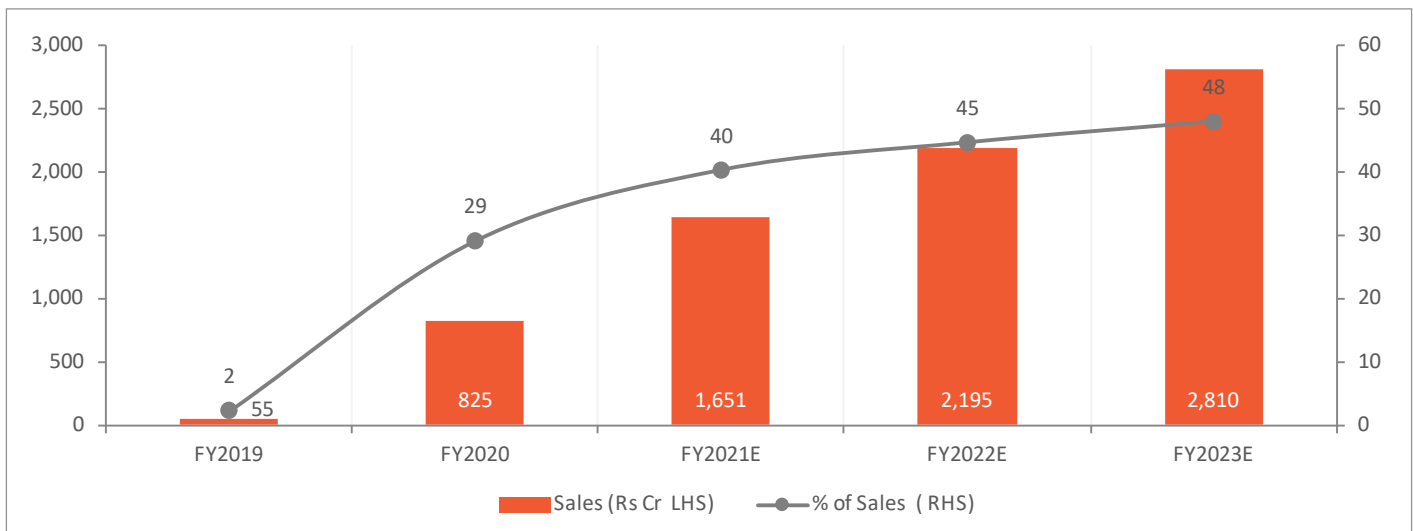
Valuation (Consolidated)

Particulars	Rs cr				
	FY19	FY20	FY21E	FY22E	FY23E
Sales	2291.9	2831.7	4094.4	4918.2	5858.7
Operating Profits	356.0	564.5	1126.0	1377.1	1652.2
OPM (%)	15.5	19.9	27.5	28.0	28.2
PAT	93.8	255.3	653.2	824.7	1025.5
PATM (%)	4.1	9.0	16.0	16.8	17.5
EPS	1.8	4.8	12.3	15.5	19.3
P/E	191.2	70.2	27.4	21.7	17.5
EV/EBIDTA	53.5	33.5	16.8	13.5	11.2
ROE (%)	6.0	14.4	27.0	25.4	24.0
ROCE (%)	7.2	13.2	26.2	26.3	25.9

Source: Company; Sharekhan estimates

Formulations segment on a strong footing backed by sturdy growth and capacity expansion: Laurus is witnessing improved traction for its formulations segment and the company expects the H2FY21 to be better than H1FY2021. The tender business accounts for around three-fourths of the total formulations segment sales and has robust growth outlook backed by a sturdy demand of ARV's. With strong demand, the management anticipates capacity constraints going ahead. Consequently, it is expanding capacities, primarily through brownfield expansion. The first leg of de-bottlenecking is expected to be over by end of Q4FY2021, while the second leg of expansion would be done in two phases, which would go on stream by September 2021 and December 2021. Cumulatively, the formulations capacity would increase by 80% over the next two years. Laurus is eyeing a revenue potential of 1.5-2x from the new capacities. Moreover, traction from North America and EU is expected to sustain going ahead and would aid topline growth.

Formulation sales to soar



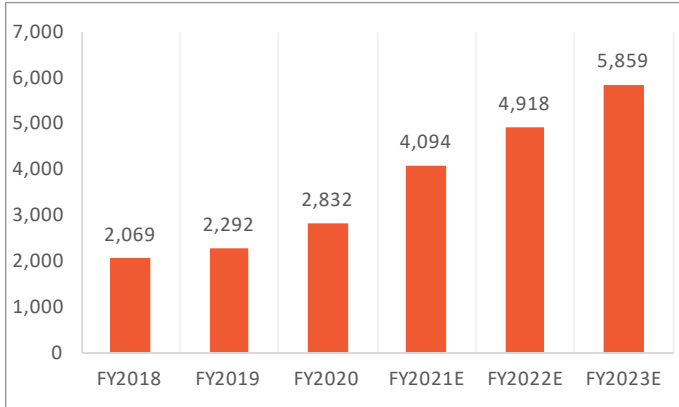
Source: Company; Sharekhan Research

Custom synthesis business to clock double-digit growth: Laurus's custom synthesis business is witnessing an improved traction backed by sturdy client wins done by the company. For H1FY2021, segmental revenues were up ~37% y-o-y and traction is expected to sustain going ahead as well. However there are capacity constraints emerging for the segment, and the company is in the process for expanding capacities, so as to support growth. However given the commencement of commercial supplies of four products in H1FY2021, would aid the revenue growth for custom synthesis segment for FY2021. Going ahead with expanded capacities coming on-stream during FY2022 and an increase in commencement of commercial supplies, would drive growth for the custom synthesis business. The segment's sales are expected to clock a 19% CAGR over FY2020 to FY2023.

Capex to drive Richcore's topline FY2022 onwards: Laurus' acquisition of Richcore Lifesciences Private Limited (RLPL) is expected to yield substantial synergies going ahead and is expected to complement the company's aggressive growth strategies. RLPL operates through three distinct revenue streams – Biotech, Enzymes, and CDMO, among which its revenues are equally split. Going ahead, this is expected to change with the CDMO segment likely to be a major contributor to growth as chunk of the incremental capacities are towards this business. As of September 2020, RLPL had one plant with a capacity of 17500 litres operational and it is in the process of setting up another plant with a capacity of 1.8 lakh litres that is likely to be ready by the end of FY2021. New capacities are unlikely to require any major compliance approvals and are already pre-booked by existing clients. RLPL's CDMO capacity caters to the requirement of the clients largely in exports markets (US and Europe) and focused on the food industry. Hence, post the completion of the plant, RLPL would be in a position to commence commercial production from the new capacity. The new capacity has entailed an investment of Rs 90 crore and the company expects asset turnover of around 1.5x with the revenues spread across FY2022 and FY2023.

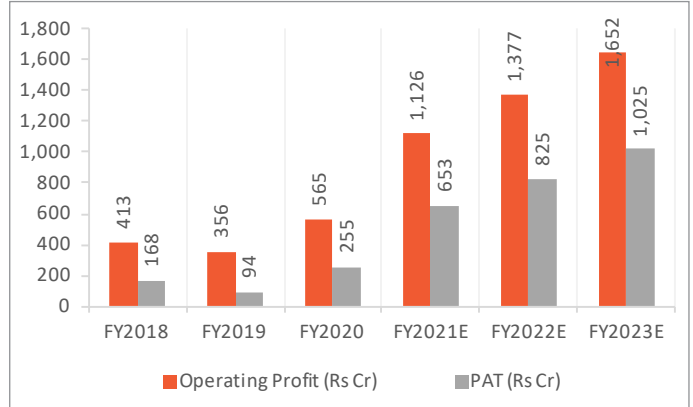
Financials in charts

Sales Trends (Rs Cr)



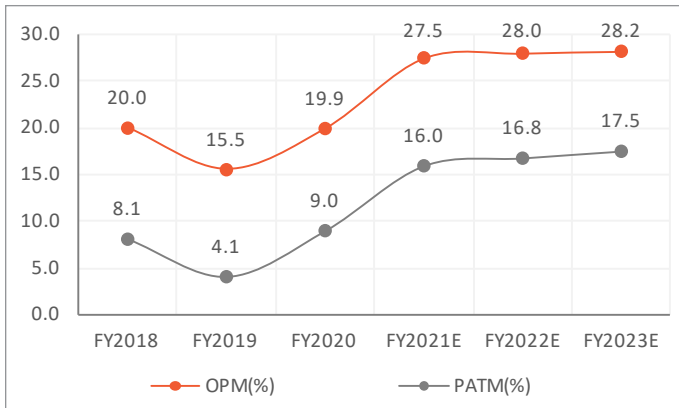
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



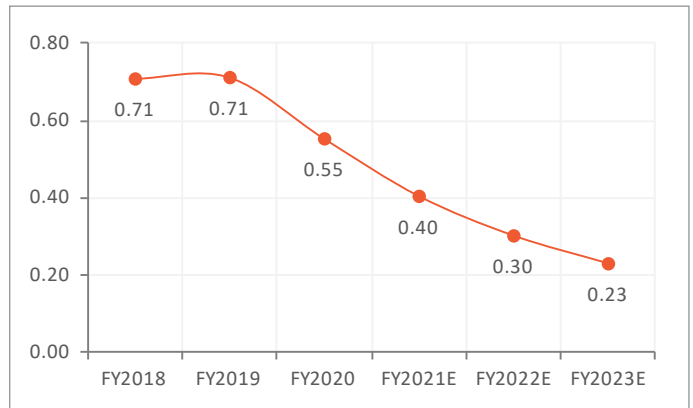
Source: Company, Sharekhan Research

Margin Trends



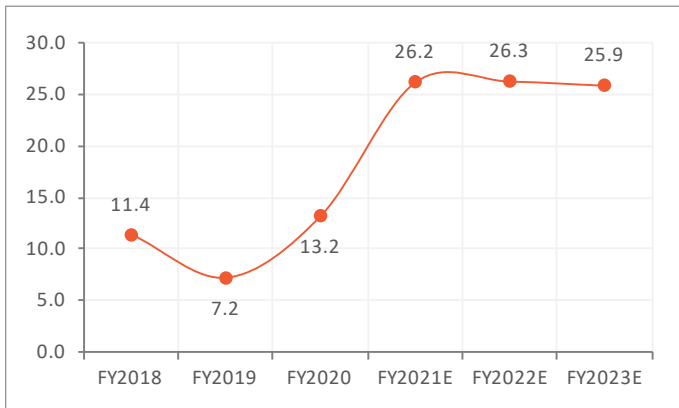
Source: Company, Sharekhan Research

Improving Leverage (D:E)



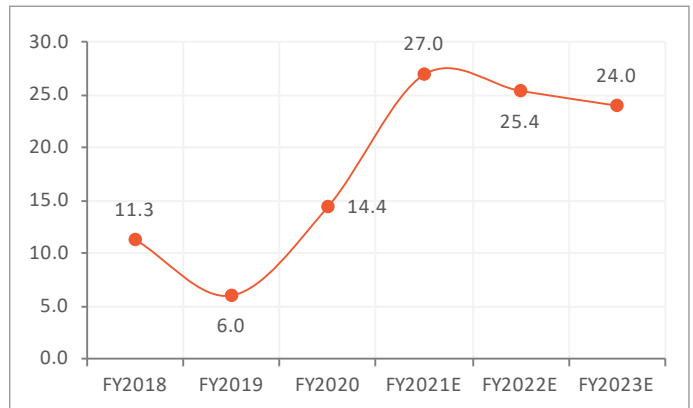
Source: Company, Sharekhan Research

RoCE Trend (%)



Source: Company, Sharekhan Research

Return ratios to improve (RoE %)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Growth momentum to improve

Indian pharmaceutical companies are better placed to harness opportunities and report healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in the US generics market), rise in product approvals, and plant resolutions by the USFDA coupled with strong growth prospects in domestic markets and emerging opportunities in the API space would be the key growth drivers. This would be complemented by strong capabilities developed by Indian companies (leading to a shift towards complex molecules and biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharma companies.

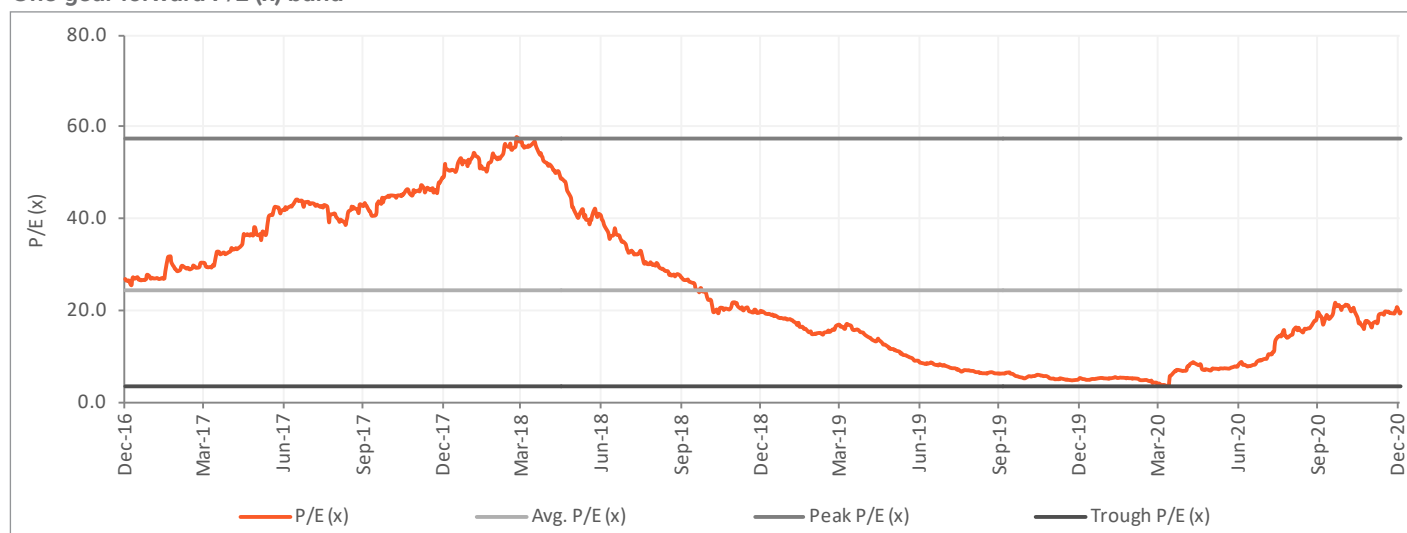
■ Company Outlook – Robust Growth prospects

The formulations business is gaining traction with new approvals and launches. The company is enhancing its current portfolio, stepping up R&D activity, and strengthening and expanding manufacturing capabilities. Further, leveraging its strengths in the API segment, Laurus has successfully forward-integrated into the lucrative formulations space and is now looking to increase its capacities in this segment by 80% so as to cater to the surging demand. Sturdy growth in the formulations business is likely to sustain going ahead. Moreover, expected traction in the synthesis business and improvement in ARVs would be the key revenue drivers. Benefits of operating leverage and a favourable product mix would result in OPM expansion. Recent acquisition of RLPL by Laurus marks its entry into the lucrative biologics space. This coupled with RLPL's strong capacities in the CDMO space augurs well and would add to growth over the medium to long term.

■ Valuation – Retain Buy with revised PT of Rs. 410

Laurus' formulations segment is witnessing elevated traction and the management expects to sustain the strong growth momentum going ahead. The tender business, which accounts for three-fourths of the overall segment revenues is on a strong footing and would be a key growth driver. Consequently performance of the formulations segment in H2FY2021 is expected to be better than that in H1FY2021. In addition to this, the custom synthesis business is also expected to clock double-digit growth over FY20 – FY23 driven by capacity expansion and rise in commencement of commercial supplies of products. Further, the company's foray in the lucrative biologics/biotech space through the acquisition of a majority stake in RLPL would be a key positive as it would create a new revenue stream for Laurus, though the benefits would accrue over the medium to long term. Strong topline growth and margin expansion (due to favorable mix) would result in a sturdy 59% earnings CAGR over FY2020 to FY2023. At the CMP, the stock is trading at a valuation of 21.7x/17.5x its FY2022E/FY2023E EPS. Sturdy growth prospects, visibility on earnings, healthy return ratios and low debt-equity are the key positives and this bodes well from a growth perspective. We retain a Buy recommendation on the stock with a revised PT of Rs. 410.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Laurus Labs	337.0	53.2	18,087.0	70.2	27.4	21.7	33.5	16.8	13.5	14.4	27.0	25.4
Granules India	362.0	24.7	8,961.0	27.1	16.2	14.0	17.5	10.4	8.5	17.9	23.7	22.1

Source: Company, Sharekhan estimates

About company

Laurus is a leading research-driven pharmaceutical company, working with nine of the world's top 10 generic pharmaceutical companies in the world. Laurus sells APIs in 56 countries. The company's major focus areas include anti-retroviral, Hepatitis C, and Oncology drugs. Oncology is one of its core competencies, where it offers a comprehensive range of APIs in this segment. Laurus is continuously extending its portfolio by focusing on molecules in diabetes, ophthalmology, and cardio-vascular therapy areas. Laurus has four distinct business units, namely: Generics API, Generics FDF, Ingredients, and Synthesis.

Investment theme

Built on strong capabilities in chemical development and manufacturing, Laurus has developed a wide range of in-house APIs and intermediates. Laurus is one of the world's leading suppliers of anti-retroviral APIs and intermediates. The company's low-cost technologies give it an edge over other players. Leveraging on API cost advantage for forward integration into generic formulations (FDF) and capitalising on its leadership position in APIs (in key areas such as oncology, cardio-vascular, anti-diabetics, and ophthalmology) with foray into other regulated markets will drive the company's business over the next couple of years. Moreover, the company is doubling its capacity to support growth in the formulations business, which points towards healthy growth going ahead. The recent acquisition of RLPL by Laurus marks its entry into the lucrative biologics space and would be growth accretive over the medium to long term.

Key Risks

1. Slower-than-expected ramp-up in formulations or custom synthesis businesses.
2. Reforms in the healthcare industry and uncertainty associated with pharmaceutical pricing, reimbursement, and related matters could affect pricing and demand for Laurus' products.

Additional Data

Key management personnel

Dr. Satyanarayana Chava	Executive Director and CEO
Mr. V V Ravi Kumar	Executive Director and CFO
Dr. Lakshmana Rao C V	Executive Director
Mr. Krishna Chaitanya Chava	Executive Vice President, Head – Synthesis & Ingerdients

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Ambit Capital	11.7
2	Amansa Holdings Pvt Ltd	6.1
3	Government Pension Global Fund	1.8
4	Vanguard Group Inc	1.2
5	Blackrock Inc	0.9
6	Norges Bank	0.9
7	HSBC Holdings	0.7
8	Kotak Mahindra Asset Management Co	0.7
9	UTI asset Management Co Ltd	0.6
10	ICICI Prudential Asset Management Co	0.6

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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