Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Laurus Labs Ltd

Well placed to take the next big leap

Pharmaceuticals	Sharekhan code: LAURUSLABS
Reco/View: Buy ↔	CMP: Rs. 590 / Price Target: Rs. 735 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We reiterate our Buy recommendation on Laurus Labs (Laurus) with an unchanged PT of Rs. 735.
- Laurus is fortifying its position in FD and synthesis segments, strengthening its presence in non- ARV space and growing in new area of biologics, through Laurus Bio. Strong demand environment well complimented with capacity expansion would drive the growth ahead.
- Emerging opportunities from patent expiry of drugs in areas of anti-diabetes and cardiology offer significant potential for Laurus and could drive the growth in Other API's as well as FD's
- Channel de-stocking in the ARV API's is gradually easing out and normalization is likely by Q1FY23. Management interaction suggests towards a possible sequential improvement in Q4FY22.

We recently had an interaction with Laurus Lab's (Laurus) management to get an update on the business. The commentary was encouraging and pointed at strong levers in place that could drive the growth ahead. Transient issues such as channel de-stocking for the ARV API's are gradually easing out pointing towards likely normalcy in Q1FY23. Cost headwinds such as higher solvent and freight cost are likely to be offset partly by efforts to diversify vendor base geographically, increasing backward integration levels, thereby reducing import dependence. The growth outlook for FD (Finished dosages) and synthesis segment stays healthy, while API's are expected to stage a gradual improvement.

Incremental capacities to drive FD segment growth: Despite a high base, the FD sales have staged a strong 13% y-o-y growth for 9MFY22 and the management expects the traction to improve further. Laurus in 1HFY2022 commissioned 1 billion tablets capacity and has planned to commission another 4 billion tablet capacity by Q1 FY23 thus doubling the FDF segment's capacity to 10 billion tablets per year, which is substantial. Material benefits from capacity expansion plans are likely to be visible FY2023 onwards. Healthy demand environment, well complimented by commissioning of expanded capacities provide ample visibility on the growth.

Synthesis segment to sustain the double-digit growth trajectory: Laurus's synthesis business has recorded an impressive 62% y-o-y growth for 9MFY2022, backed by traction in existing commercialised molecules and new customer additions. In addition to the emerging opportunities at the industry level, the recent win of a multi-year contract with a global life sciences company bodes well and the company is investing around Rs 450 cr to set up a dedicated facility for the same. Benefits from the contract are expected to accrue from FY2025E and provides ample visibility on long-term growth. Also Laurus Bio is expected to gain significant traction as it has recently completed a massive expansion plan. Overall collectively, Synthesis and Laurus Bio account for ~18% of the overall 9MFY22 sales and by FY2025E the management expects this to increase to 25%.

API segment to stage a gradual improvement: High base, channel de-stocking in its key end user markets have led to a 18% y-o-y decline in 9MFY22 API sales. Amongst the API's the ARV API's wre the most impacted which recorded a decline of 26%. Though the management expects a material improvement to be visible in ARV-API's from Q1FY23 onwards, our interactions points towards a likely sequential improvement in Q4FY22, which bodes well. Secondly, in order to reduce dependence on ARV API's, Laurus is eyeing the other API space (diabetes and cardiology) to fuel growth. Collectively, while the ARV API's are on the path to improvement, long term plans to enter the Other API's (Diabetology and Cardiology) provide visibility on growth ahead.

Our Call

Valuation – On the path to improvement, re-iterate Buy: Transient issues in ARV-API sales are likely to normalize by Q1FY23 with a possible sequential improvement. Doubling tablet capacity to 10 bn tablets per year could drive FDF segments sales with a marked improvement likely from FY23E onwards. The Synthesis segment, backed by a growth in demand from existing customers, and ongoing client additions, is set to stage a strong double-digit growth. Due to an expected sequential improvement in the ARV-API's the Q4FY22 performance is expected to be better as compared to Q3FY22. At the CMP, the stock trades at 33.5x/22.8x/17.4x its FY22E/FY23E/FY24E EPS. Given multiple growth levers pointing towards strengthening growth prospects, we reiterate our Buy recommendation on the stock with an unchanged PT of Rs. 735.

Key Risks

Slower ramp up of new FD facilities, and delay to commercialize products in the synthesis segment Any delay in product approvals or any negative outcome of facility inspection by the USFDA can affect earnings prospects.

Valuation (Consolidated) Rs cr

Particulars	FY20	FY21	FY22E	FY23E	FY24E
Sales	2831.7	4813.5	5252.1	7123.2	8843.9
Operating Profits	564.5	1550.7	1601.9	2265.2	2892.0
OPM(%)	19.9	32.2	30.5	31.8	32.7
PAT	255.3	983.9	937.5	1376.5	1807.9
EPS	4.8	18.5	17.6	25.9	34.0
P/E	123.0	31.9	33.5	22.8	17.4
EV/EBIDTA	57.3	21.1	20.5	14.5	11.2
ROE (%)	14.4	37.9	26.5	28.0	26.9
ROCE (%)	13.2	32.2	25.4	29.2	29.7

Source: Company; Sharekhan estimates

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 43.39

Updated Jan 08, 2022

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

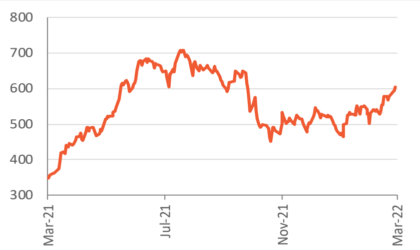
Company details

Market cap:	Rs. 31,693 cr
52-week high/low:	Rs. 724 / 346
NSE volume: (No of shares)	28.1 lakh
BSE code:	540222
NSE code:	LAURUSLABS
Free float: (No of shares)	39.0 cr

Shareholding (%)

Promoters	27.3
FII	24.1
DII	6.9
Others	41.7

Price chart



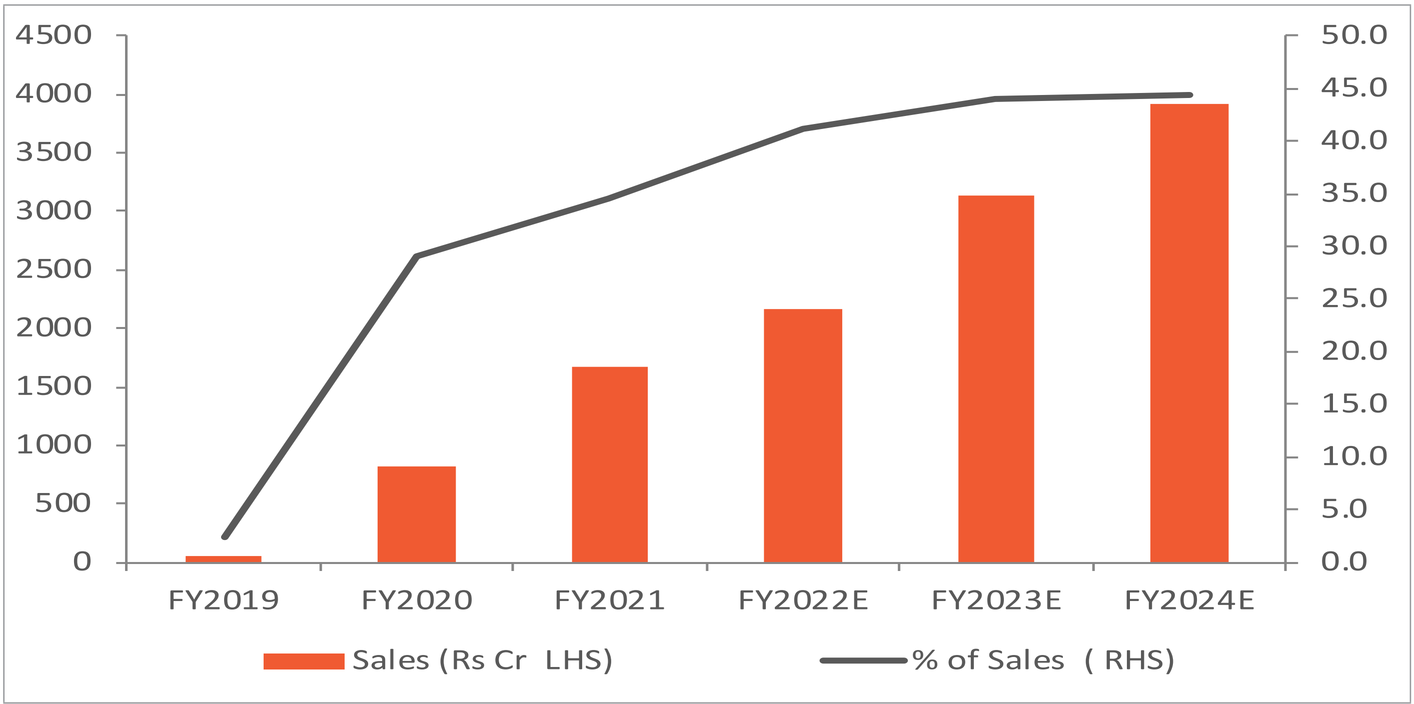
Price performance

(%)	1m	3m	6m	12m
Absolute	11.2	17.6	-3.2	69.5
Relative to Sensex	8.5	17.2	1.2	51.1

Sharekhan Research, Bloomberg

FD segment on a strong footing; incremental capacities to support growth: The finished dosages (FD) segment of the company is witnessing improved growth traction and is expected to be a key growth driver for the company. The FD segment revenues have staged a strong performance growing from Rs. 54 crore in FY2019 to Rs. 1664 crore in FY2021. Further in 9MFY22 , the FD sales have staged a 13% y-o-y growth, which is healthy given the high base in previous year. Going ahead, the strong traction is expected to improve further and drive the overall growth of the company. In 1HFY2022, Laurus commissioned 1 billion tablets capacity and has planned to commission another 4 billion tablet capacity by Q1 FY23 thus doubling the FDF segment's capacity to 10 billion tablets per year, which is substantial. Material benefits from capacity expansion plans are likely to be visible in FY2023. Further the expanded capacities do not need regulatory approvals as they are at an already approved site. With the product approvals flowing in, the utilization rates of the new capacities could improve gradually and would add to the overall growth of the company. Collectively, a healthy demand environment, well complimented by commissioning of expanded capacities provide ample visibility on the growth ahead for formulations segment.

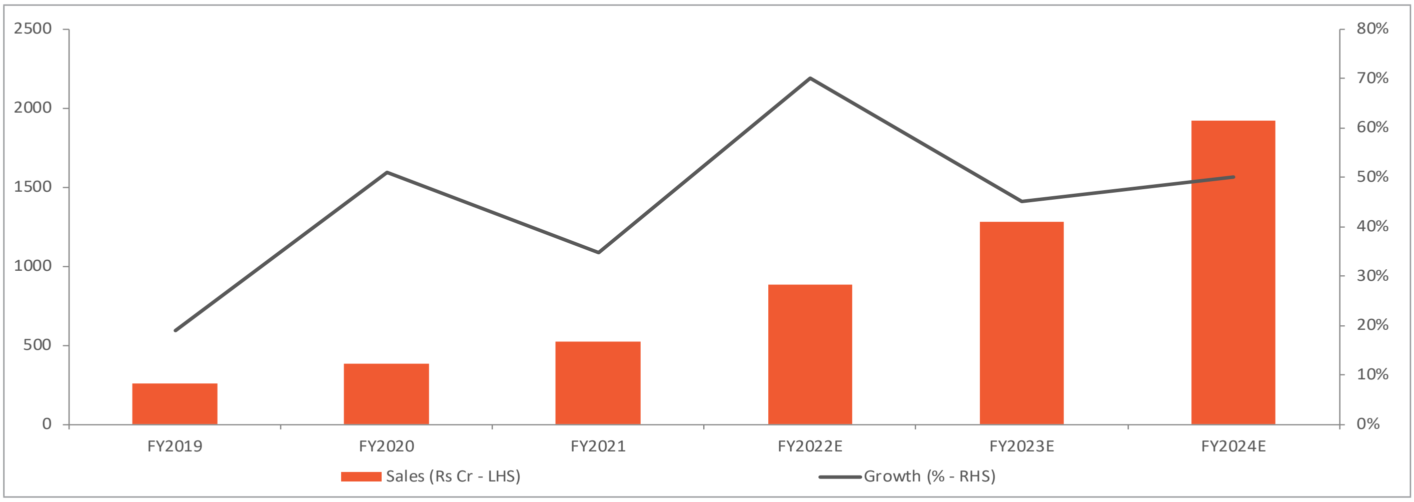
Formulation Sales to Soar



Source: Company; Sharekhan Research

Synthesis segment to stage a strong double digit growth: Laurus's synthesis business has staged a strong 62% y-o-y growth in the 9MFY22 while for FY2021 the revenues from the segment has staged a growth of 35% y-o-y for FY2021, thus pointing at remarkable improvement. Going ahead, the growth is expected to sustain supported by client additions and increasing commercialization of products along with the traction in existing products. On the industry front, the CRAMS industry is expected to grow at a healthy pace (~7% CAGR over 2019-2025) led by increasing costs of R&D, coupled with better outsourcing opportunities, especially for the Indian companies. India offers significant cost advantages over matured manufacturing hubs in Europe and North America and has already emerged as one of the leading cost-competitive and quality focused manufacturing hubs for many global players including big pharma companies. Industry reports indicate that domestic CRAMS market is expected to reach $40 billion by 2030 and this points at a substantial opportunity. In addition to the emerging opportunities at industry level, recently Laurus has entered in to a multiyear contract with a global life science company and the scope involves developing and manufacturing molecules. Laurus would be setting up a dedicated facility for the same with an expected investment of Rs. 450 crores. Benefits from the contract are expected to accrue from FY2025 and provides ample visibility on long-term growth. In addition to the Synthesis business, the Laurus Bio is also expected to gain material traction as it has recently completed a massive expansion plan. Simultaneously, Laurus has now charted out an expansion plan to increase the fermentation capacity to 1 mn KL and is in the process of acquiring land for the same. Overall collectively (Synthesis and Laurus Bio) account for 18% of the overall 9MFY22 sales and by FY2025 the management expects this to increase to 25%.

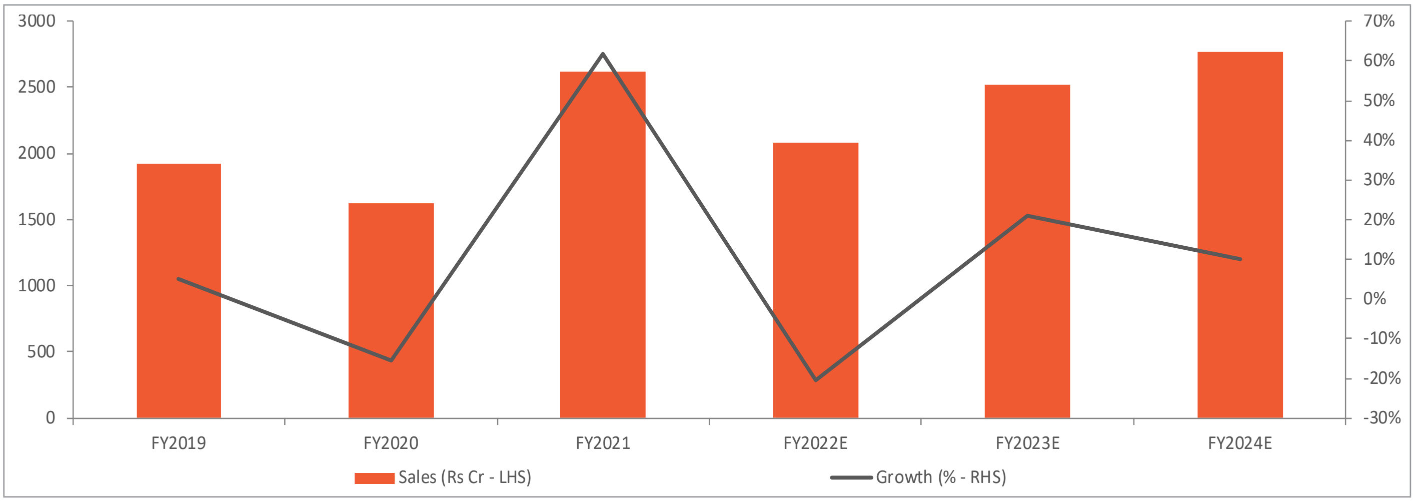
Synthesis segment to stage strong double-digit growth



Source: Company; Sharekhan Research

API segment to stage a gradual improvement: Laurus' API segment (55% of Fy21 sales) after posting a strong 62% growth for FY2021, has now reported a decline of 18% y-o-y for 9MFY22. A high base of the previous year, channel de-stocking in its key end user markets (anticipating a third wave, the dealers and distributors had stocked up inventories) have resulted in a decline. The ARV API sales (48% of Q3FY22 API Sales v/s 70% in FY21) were the worst hit, which resulted in a decline in the sales. Though the management expects a material improvement to be visible in ARV-API's from Q1FY23 and onwards, our interactions with the company suggests that there could be a sequential improvement in Q4 v/s Q3, which bodes well. Secondly, in order to diversify its presence in the other API's (and simultaneously also reduce dependence on ARV API's), Laurus is eyeing the diabetes and cardiology space as many molecules are expected to go off patent over the next two years. Initially Laurus expects to focus on the API and then gradually move in the FD space as well. Collectively, while the ARV API's are on the path to improvement, a material revival is likely in Q1FY23, while the management expects the performance to improve sequentially. Over the long term, plans to enter the Other API's (Diabetology and Cardiology) would drive the growth of the API's.

API Segment Sales Trends

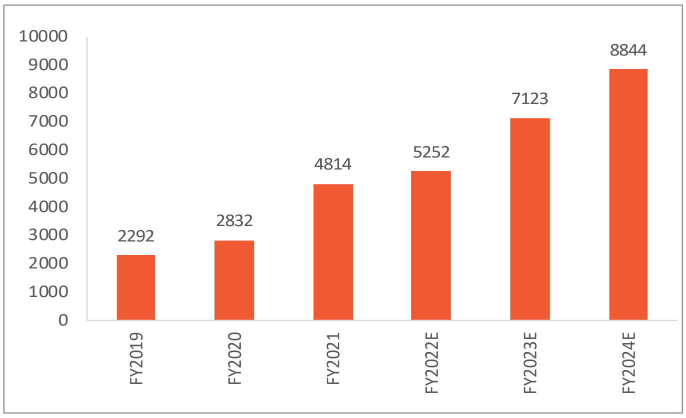


Source: Company; Sharekhan Research

Margins to improve over the medium to long term: Laurus's margins have been recently impacted by higher freight costs and solvent costs and the same is reflected in the operating margins which have declined by 300 bps y-o-y to 29% for 9MFY22. Management sees initiating a price hikes in a tough environment to be a challenge, though is some pockets it has managed to pass on the price hikes. Also the company is exploring / evaluating other levers which include diversifying the vendor base, reducing dependence on china imports, and increasing the backward integration levels. While these levers are likely to play out in the medium term, in the near term high freight cost and solvent costs are likely to restrict the margins expansion. Overall Laurus' OPMs are expected to improve from 30.5% in FY22 to 32.7% as of FY24E.

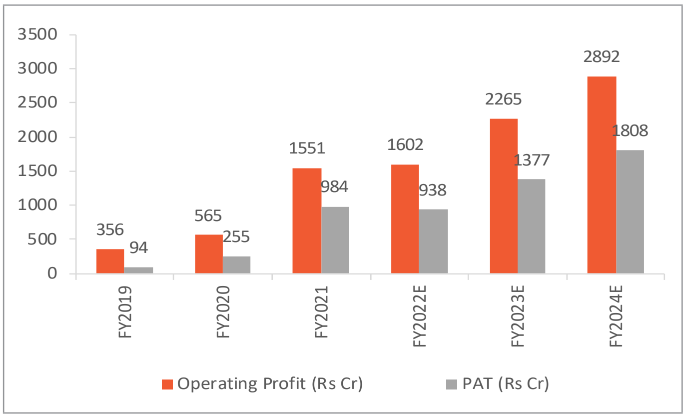
Financials in charts

Sales Trends (Rs Cr)



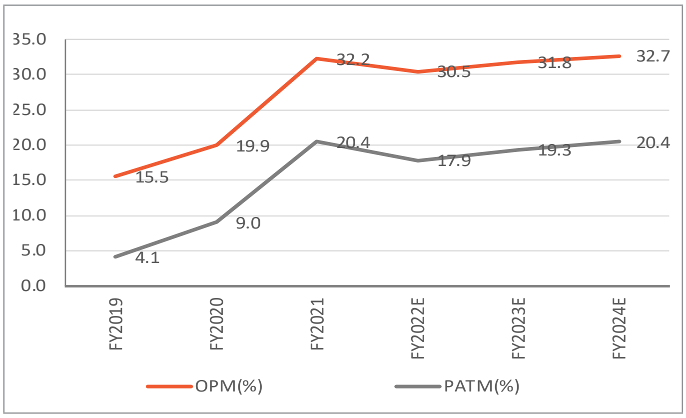
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



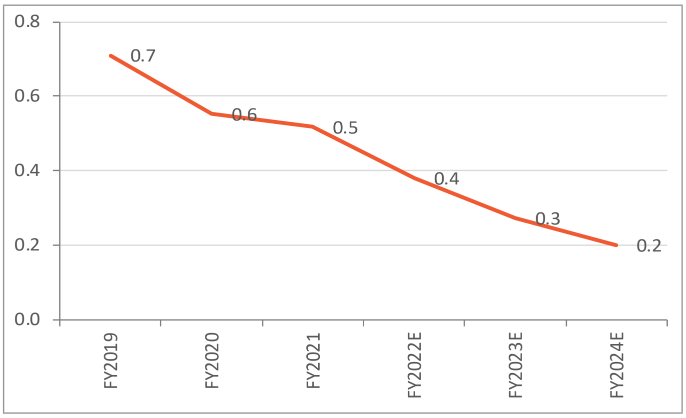
Source: Company, Sharekhan Research

Margin Trends



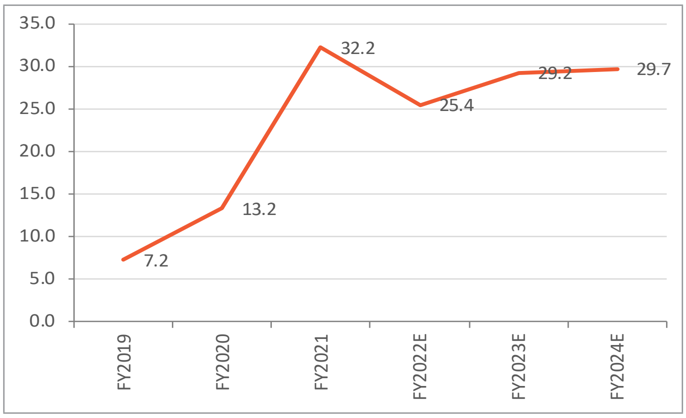
Source: Company, Sharekhan Research

Improving Leverage



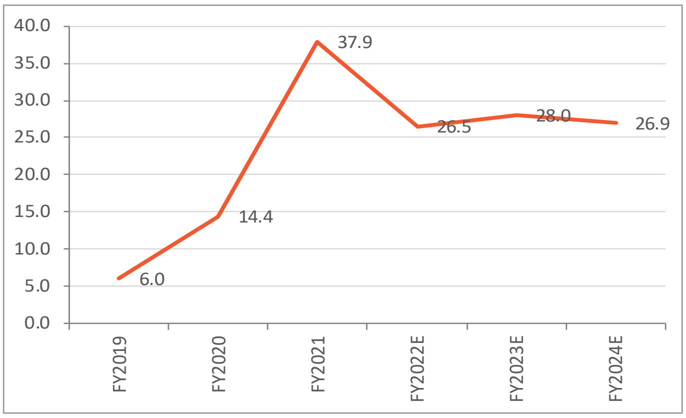
Source: Company, Sharekhan Research

RoCE Trend (%)



Source: Company, Sharekhan Research

RoE Trend (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector outlook – 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, plant resolutions by the USFDA, strong growth prospects in domestic markets, and emerging opportunities in the API space would be 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.

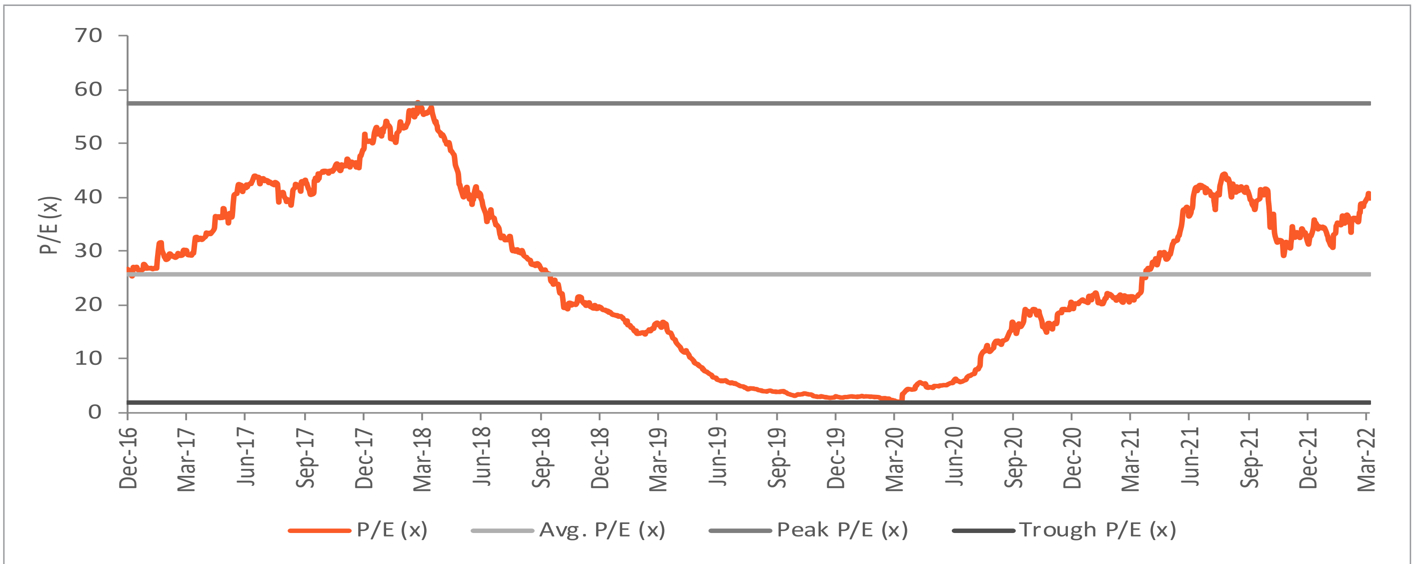
■ Company outlook – Long-term levers intact

All of Laurus' businesses have a strong growth outlook backed by improving demand and supported by capacity expansion plans lined up. The company is enhancing its current portfolio, stepping up R&D activity, and strengthening and expanding manufacturing capabilities. Further, Laurus is looking to almost double its formulations capacities so as to cater to surging demand and management is confident of sustaining the strong growth momentum. Further, over the long term, Laurus is also in the process to diversify to non-ARVAPIs of cardiology and diabetology and is in the process to reduce the dependence on the ARV segment. In addition, the synthesis business is expected to grow strongly in the next two years with sustained new client additions, growth in existing business, and likely commercialization of new products. The management is quite optimistic on the performance of the synthesis division and sees this as one of the key growth drivers. Laurus Bio is also expected to grow substantially over the next 4-5 years and would make the company a fully integrated player in the pharmaceutical space. Benefits of operating leverage and a favourable product mix would result in operating profit margin (OPM) expansion. However, channel de-stocking for ARV API and input cost pressures could act as near-term headwinds/transient issues.

■ Valuation – Reiterate Buy with an unchanged PT of Rs. 735

Laurus' FD an Synthesis segments has a healthy growth outlook backed by a expected improvement in the demand environment, expanding capacities. Doubling of tablet capacity to 10bn tablets per year effective Q1FY23, would drive the FD segment sales while traction in existing contracts and likely new customer addition to fuel the Synthesis segment sales. Laurus Bio's performance is also expected to improve backed by expanded capacities, which could support the growth. The ARV API business in on its path to improvement with a material improvement likely in Q1FY23. Higher raw-material prices, especially solvent prices, elevated freight costs could exert margin pressures, but levers to offset the same are expected to play out in the near term. Backed by an expected sequential improvement in the ARV-API's the Q4FY22 performance is expected to be better as compared to Q3. At CMP, the stock trades at 33.5x/22.8x/17.4x its FY22E/FY23E/FY24E EPS. Given multiple growth levers pointing towards improving growth prospects we reiterate our Buy recommendation on the stock with an unchanged PT of Rs. 735.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBITDA (x)			RoE (%)		
				FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Laurus Labs	590.0	53.2	31,693.0	31.9	33.5	22.8	21.1	20.5	14.5	37.9	26.5	28.0
Granules	319	45.3	7,901	14.3	19.0	14.0	9.8	12.2	8.8	25.3	16.3	18.9
Divis Labs	4457	3.5	118307	59.6	45.7	37.3	39.7	31.2	25.2	21.3	23.0	23.0

Source: Company, Sharekhan estimates

About the company

Laurus is a leading research-driven pharmaceutical company, working with nine of the world's top 10 generic pharmaceutical companies in the world. The company 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 capitalizing 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. Overall, in the wake of an expected robust growth outlook, Laurus has embarked on a massive capex programme for the next two years, which provides ample growth visibility.

Key Risks

- Slower-than-expected ramp-up in formulations, API, or custom synthesis businesses.
- Reforms in the healthcare industry and uncertainty associated with pharmaceutical pricing could affect the company's growth prospects.

Additional Data

Key management personnel

Dr. Satyanarayana Chava	Founder and CEO
Mr. V V Ravi Kumar	Executive Director and CFO
Dr. Lakshmana Rao C V	ED and Head, Quality
Mr. Krishna Chaitanya Chava	Head – Synthesis Division

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Capital Group cos Inc	8.2
2	New World Fund Inc	4.8
3	Amansa Holdings Pvt Ltd	3.8
4	Anukar Projects Pvt Ltd	3.2
5	Smallcap World Fund Inc	3.1
6	Life Insurance Corporation of India	2.2
7	Vangaurd Group Inc	2.1
8	BlackRock Inc	1.2
9	HBM Healthcare Investments Cayman	0.7
10	Kotak Mahindra Asset management Company Ltd	0.6

Source: Bloomberg

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 detoriating 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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