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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

Updated Feb 08, 2022

43.39

Severe Risk

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

Source: Morningstar

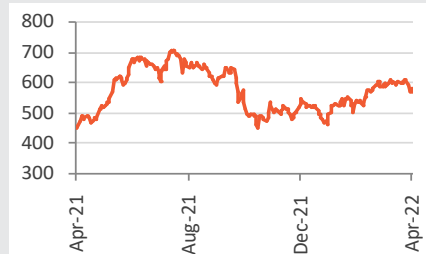
Company details

Market cap:	Rs. 31,362 cr
52-week high/low:	Rs. 724 / 433
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	-1.8	16.8	13.2	27.4
Relative to Sensex	-0.3	17.1	17.0	12.8

Sharekhan Research, Bloomberg

Laurus Labs Ltd

Concerns easing out; Valuations turn attractive

Pharmaceuticals

Sharekhan code: LAURUSLABS

Reco/View: Buy



Upgrade



Maintain



Downgrade

CMP: Rs. 584

Price Target: Rs. 735

Summary

- Laurus Labs reported muted results for Q4FY22 with PAT marginally missing estimates.
- Management commentary on outlook for the Synthesis and FDF segments was encouraging, while the API segment's performance is likely to normalise in FY23. Consequently, the management has retained its \$1 billion revenue guidance for FY23
- Citing the strong demand environment Laurus has revised its capex guidance upwards to Rs 2000-2500 crore spread over the next two years
- At CMP, the stock trades at 24.8x/19.0x its FY23E/FY24E EPS, which provides ample headroom for expansion. We retain Buy recommendation with an unchanged PT of Rs. 735.

Laurus Labs Limited (Laurus) reported muted results for Q4FY22 with PAT marginally missing estimates. Results were affected by weak performance of anti-retroviral (ARV) APIs and higher cost pressures. However, sequentially, topline growth improved markedly and this along with positive management commentary, points at a likely gradual improvement. Management commentary on outlook for the Synthesis and FDF segments was encouraging, while the API segment's performance is likely to normalise in FY23. Consequently, the management has retained its \$1 billion revenue guidance for FY23 and sees EBITDA margins at ~30% levels over the next one year.

Key positives

- The synthesis segment's sales doubled staging an impressive 105% y-o-y growth to Rs 360 crore.
- FD segment sales reported a double digit growth of 14.2% y-o-y showing signs of a pick up
- Laurus sees the demand trends normalizing for the API's and sees a growth in FY23 in API sales

Key negatives

- OPMs contracted by 560 bps y-o-y on the back of a elevated cost pressures with a 350 bps decline in gross margins.

Management Commentary

- Laurus sees the synthesis segment to be a key growth driver and the expects the growth to be drive by new client additions, increased business from existing clients and contract wins.
- Laurus expects new approvals in anti-diabetes and Cardiovascular therapy for the EU and US markets and expects this to drive the Other API and FDF segment sales. Doubling of FDF capacity to 10 billion tablets by June 2022 would also support the growth.
- Laurus is seeing a strong demand environment across segments and to be able to cater to the same, the company has raised capex plans to Rs 2000-2500 crore for the next two years.

Revision in estimates – Q4FY22 was muted quarter for Laurus and results marginally missed estimates. However, the commentary on the growth and outlook was encouraging and provides ample visibility. Given the muted quarterly performance and a strong growth outlook, we have fine-tuned our FY23E/FY24E earnings estimates.

Our Call

Valuation – Retain Buy with unchanged PT of Rs. 735: Based on encouraging growth prospects, that are well-supported by capacity expansion plans, the management has retained its revenue guidance of \$1 billion by FY2023, despite near-term challenges, that bodes well from a growth perspective. Citing the strong demand environment, the management has revised its capex guidance upwards and this provides comfort on the growth ahead. At CMP, the stock trades at 24.8x/19.0x its FY23E/FY24E EPS, which provides ample headroom for expansion. We retain Buy recommendation on Laurus with an unchanged PT of Rs. 735.

Key Risks

Any delay in product approvals or any negative outcome of facility inspection by the USFDA can affect earnings prospects.

Valuation (Consolidated)

Particulars	Rs cr				
	FY20	FY21	FY22	FY23E	FY24E
Sales	2831.7	4813.5	4935.6	7053.5	8570.4
Operating Profits	564.5	1550.7	1422.4	2116.1	2674.0
OPM(%)	19.9	32.2	28.8	30.0	31.2
PAT	255.3	983.9	832.2	1254.2	1636.8
EPS	4.8	18.5	15.6	23.6	30.8
P/E	121.7	31.6	37.3	24.8	19.0
EV/EBIDTA	56.8	20.9	23.0	15.6	12.2
ROE (%)	14.4	37.9	24.8	27.2	26.2
ROCE (%)	13.2	32.2	21.6	26.3	27.1

Source: Company; Sharekhan estimates

Muted quarter, results marginally miss estimates

Q4FY22 results were muted with the PAT missing estimates marginally. The results were affected by weak performance of the ARV APIs and elevated cost pressures. However sequentially Laurus has reported a marked improvement on topline growth and this coupled with the management commentary points at a likely gradual improvement. Sales at Rs 1424 crore was almost flat y-o-y. API segment sales at Rs 539 crore declined by 32.4% y-o-y on the back of a 47.9% decline in the ARV API sales attributable to higher base and some impact of higher channel inventories. The FD as well as Synthesis segments reported a strong performance staging a growth of 14.2% and 104.5% y-o-y, respectively. The operating margins at 27.8% (as against estimated 27%) contracted sharply by 560 bps y-o-y attributable to an overall increase in the cost pressures. However sequentially the margins remained almost constant. Operating profit grew at Rs 396.7 crore de-grew by 16% y-o-y but improved sharply by 39% sequentially. The gross margins contracted sharply by 350 bps y-o-y while employee costs and other expenses too increased by 100 bps and 110 bps y-o-y respectively. However, sequentially the margins remained almost constant. Higher interest cost and depreciation coupled with lower other income resulted in PAT declining by 22% y-o-y and slightly missed streets estimates.

Q4FY2022 Concall Highlights

- ♦ **Strong demand seen across Synthesis and FDF; Laurus retains \$1bn topline guidance for FY23:** Laurus' synthesis business has staged a strong 105% y-o-y growth in the revenues for Q4FY22. The strong growth can be attributable to the sustained new client additions and increased business from the existing clients. Additionally, Laurus has recently secured an order from a global life sciences company and the supplies of the molecule have commenced in Q4FY22, with FY23 expected to witness a ramp up in the supplies. Supplies for the new molecule are for API as well as FD segment. Going ahead the growth prospects for the synthesis segment are strong and the company is in the midst of capacity expansion plan where in it plans to set up a dedicated facility for API for CDMO segment, considering strong demand. Traction from the existing customers, new client additions and strong demand environment supported by capacity expansion plans are the key factors to fuel the growth in the API segment. The generic FDF segment sales too have staged a double digit growth of 14.2% y-o-y while improving sequentially also. Gradual stabilization of the ARV demand, portfolio expansion in the developed markets, in which the company leverages its own front end and strong product pipeline have fueled the growth. Going ahead, the outlook is strong supported by a strong demand environment. Also the capacity expansion plan for the FD segment is in place and the management expects to commercialise the new capacity by June end, which would take the overall capacity of FD segment to 10 bn tablets per year. As Laurus has a strong product pipeline in the US with 31 ANDA's filled cumulatively including 15 Para IV and 10 FTF opportunities, the brownfield expansion bodes well and will enable to cater to the likely surge in the demand due to product portfolio expansion. Backed by the commissioning of 4 fermenters each with a capacity of 45,000 kilolitres in FY22, the revenues from Laurus Bio are also set to grow substantially. Overall, with the channel destocking being a transient issue, the API segment sales are expected to normalize and the outlook stays robust for the other segments of FDF and synthesis. Consequently, the management has retained its revenues target of \$1-billion by FY2023, which bodes well.
- ♦ **API segment performance dragged by ARV-APIs, management expects normalizing trends to commence:** API segment sales in Q4FY22 declined steeply by 32% y-o-y to Rs. 539 crore attributable to sharp 48% drop in ARV-API sales. Prolonged channel de-stocking observed in ARV-API sales dragged down the performance and the management expects the momentum to improve gradually as it has witnessed green shoots for the same with a meaningful recovery expected in FY23. Simultaneously, the oncology API and other API revenues are witnessing a good traction clocking a 13% and 4% y-o-y growth for the quarter with a strong growth outlook backed by a strong order book. Overall, Laurus expects the ARV API segment run-rate to be normalizing in FY23 and sees the segment reviving. Further the share of revenues from the ARV's (both API and FDs) stood at 55% for FY22 and management looks to reduce this to one thirds by FY2025.
- ♦ **Capex guidance raised to Rs 2000-2500 crore over the next two years:** Laurus is witnessing an improved demand traction across its business segments and the management is targeting revenues of \$1 bn by FY2023, translating in to a strong topline growth. However in order to capture the strong demand trends the company had announced a capex plan amounting to Rs 1500-1700 crore for the two years, however

citing the strong demand scenario the company has revised its capex guidance upwards by Rs 500-600 crore to Rs 2000 to 2500 crore over the next two years. Laurus has already invested Rs. 950 crore and the balance would be spilled over to the next year. Overall, the sturdy demand outlook supported by capacity expansion, addition of new therapy areas would enable Laurus to expand its product basket and also enable higher volumes which in turn could drive market share gains going ahead.

- ◆ **Laurus Bio:** The company commenced two fermentation capacities with a capacity of 45000 KL each in H1FY22 and further in Q3FY22, it has announced a similar expansion. Incremental capacities coming on stream would add to the revenue growth. Overall the management eyes Laurus Bio revenues to grow y-o-y for FY23 but a meaningful contribution is expected in FY2025.
- ◆ **Outlook:** Laurus sees the impact of transient issues in the ARV-API sales to normalize with a possible gradual improvement expected in the subsequent quarters. With commissioning of the 4-billion tablets capacity in June 2022 the FDF segment's sales are expected to witness a marked improvement from FY23 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. Raw material availability and increasing prices (especially that of solvents), higher logistics costs, the management expects the EBITDA margins to be sustaining around 30% levels over the next one – two years.

Results (Consolidated)

Particulars	Rs cr				
	Q4FY2022	Q4FY2021	Y-o-Y %	Q3FY2022	Q-o-Q %
Total Sales	1,424.8	1,411.9	0.9	1,028.8	38.5
Operating profit	396.7	472.2	-16.0	285.3	39.1
Other income	1.3	4.5	-71.5	5.3	-75.8
EBITDA	398.0	476.7	-16.5	290.6	36.9
Interest	30.6	21.9	39.4	23.1	32.3
Depreciation	65.7	53.6	22.6	64.0	2.7
PBT	301.7	401.2	-24.8	203.5	48.3
Taxes	69.8	104.3	-33.0	48.5	43.8
Adjusted PAT	231.9	296.9	-21.9	155.0	49.6
Margins			BPS		BPS
OPM %	27.8	33.4	-560	27.7	11
Adj PATM %	16.3	21.0	-475	15.1	121
Tax Rate %	23.1	26.0	-285	23.8	-71

Source: Company; Sharekhan Research

Segment Mix

Particulars	Q4FY2022	Q4FY2021	Y-o-Y %	Q3FY2022	Q-o-Q %
ARV-API	296.5	569.0	(47.9)	203.5	45.7
Oncology-API	70.1	62.0	13.0	84.8	(17.4)
Other API	172.5	166.0	3.9	135.7	27.1
Synthesis	360.0	176.0	104.5	207.0	73.9
Generic FDF	491.0	430.0	14.2	373.0	31.6
Laurus Bio	35.0	9.0	288.9	25.0	40.0
Total	1,425.0	1,412.0	0.9	1,029.0	38.5

Source: Company; Sharekhan Research

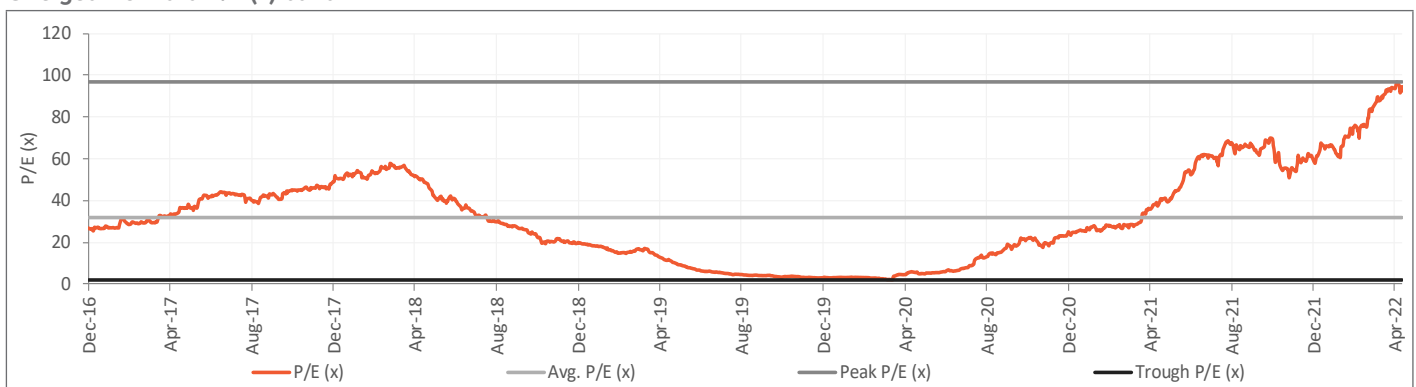
Outlook and Valuation

■ **Sector View – Growth momentum to improve:** Indian pharmaceutical companies are better placed to harness opportunities and clock 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 and strong growth prospects in domestic markets and emerging opportunities in the API space would be key growth drivers. This would be complemented by the strong capabilities developed by Indian companies (leading to a shift towards complex molecules, 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 – Growth prospects strengthening: Growth prospects across the synthesis and FDF business are strong** and are well backed by improving demand and capacity expansion plans. The company is enhancing its current portfolio, stepping up R&D activity and strengthening and expanding manufacturing capabilities. Further, Laurus is looking to 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 in to non ARV-APIs of cardiology and diabetology and in the process 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 commercialisation of new products. The management is quiet optimistic on performance of the synthesis division and sees this as one of the key growth drivers. Laurus Bio is also expected to grow substantially and would make the company a fully integrated player in the pharmaceutical space. However, channel de-stocking for ARV API and input costs pressures could act as transient issues, and the management has witnessed the green shoots of trend normalizing for the ARV API business.

■ **Valuation – Retain Buy with unchanged PT of Rs. 735:** Q4FY22 was muted quarter for Laurus and the performance was impacted by a transient issue in the ARV-API space due to channel de-stocking and higher cost pressures. The management sees ARV-APIs trends to be normalising and FY23 is likely to witness a revival in API segment sales. Backed by a strong product portfolio, capacity expansion plans the FDF segment are well set to sustain the strong growth trajectory. Also, Laurus has revised upwards its capex guidance so as to support demand buoyancy. Growth in business from existing customers, new client additions and capex plans would be key drivers for the synthesis business. Escalating raw material prices, high logistics costs could exert pressures on margins in the near to medium term. Given the weak quarterly performance and a strong growth outlook, we have fine-tuned our FY23E/FY24E earnings estimates. At CMP, the stock trades at 24.8x/19.0x its FY23E/FY24E EPS, we retain Buy recommendation with an unchanged PT of Rs. 735.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Laurus Labs	584.0	53.2	31,362.0	37.3	24.8	19.0	23.0	15.6	12.2	24.8	27.2	26.2
Granules	281	45.3	6,971	16.8	12.3	10.1	10.8	7.8	6.3	16.3	18.9	19.6
Divis Labs	4507	3.5	119649	46.3	37.7	31.8	31.5	25.5	21.2	23.0	23.0	22.2

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 gives 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 up on a massive capex program for the next two years, which provides ample visibility on growth.

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 growth prospects

Additional Data

Key management personnel

Dr. Satyanarayana Chava	Founder and CEO
Mr. V Ravi Kumar	Executive Director and CFO
Dr. Lakshmana Rao C V	ED & 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	Vanguard 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

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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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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

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