

Lasa Supergenerics Limited

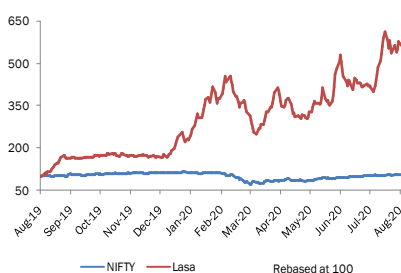
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Animal pharma niche play with diverse capabilities

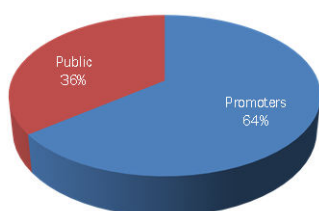
BUY

Sector	: Pharmaceuticals
Target Price	: Rs 84
Current Market Price	: Rs 59
Market Cap	: Rs 239 crore
52-week High/Low	: Rs 64/10
Daily Avg Vol (12M)	: 73,893
Face Value	: Rs 10
Beta	: 1.12
Pledged Shares	: 0%
Year End	: March
BSE Scrip Code	: 540702
NSE Scrip Code	: LASA
Bloomberg Code	: LASA IN
Reuters Code	: LASA.NS
Nifty	: 11,466
BSE Sensex	: 38,799
Analyst	: Research Team

Price Performance



Shareholding Pattern



Initiating Coverage

Investment Summary

- With a focus on animal healthcare and competencies across animal and human pharma, Lasa Supergenerics (Lasa) is a niche play with a diversified capability.
- India is a leading producer and consumer of animal protein, presenting strong domestic opportunities for Indian vet pharma companies including Lasa.
- Increasing prevalence of zoonotic diseases will drive demand for veterinary API products globally.
- Increasing awareness about preventive animal healthcare and judicious use of antimicrobials in production animals will drive demand for animal vaccines.
- Backward integration and a flexible manufacturing setup enable Lasa to quickly switch between products without incurring major capex and generate cost advantages. The company's R&D practice looks to develop products with the objective of building a pipeline while also enhancing existing processes.
- Approval for Progesterone and collaboration for the COVID-19 drug Favipiravir present new opportunities for Lasa, especially in the wake of the coronavirus pandemic.
- We expect robust topline growth during FY21 in line with the solid 1Q FY21 performance, followed by normalized healthy growth in FY22. Operating leverage will drive margin expansion with incremental effect at the PAT level due to lower interest expense / debt, leading to solid gains in ROCE and ROE. Basis strong earnings growth forecast, the Lasa stock trades at very attractive forward P/E levels of 11.4x and 9.0x FY21E EPS and FY22E EPS, respectively. Valuing at 13.0x FY22E EPS, our target price of Rs 84 informs a BUY rating with an upside potential of 44%.

Key Financial Metrics

Rs lakh	FY18A	FY19A	FY20A	FY21E	FY22E
Operating revenue	24,584	16,957	16,727	22,046	24,758
Growth		-31.0%	-1.4%	31.8%	12.3%
EBITDA	4,133	1,111	2,995	4,762	5,397
EBITDA margin	16.8%	6.6%	17.9%	21.6%	21.8%
PAT	1,234	(1,203)	363	2,094	2,640
PAT margin	5.0%	-7.1%	2.2%	9.5%	10.7%
Diluted EPS (Rs)	5.40	(5.26)	1.35	5.15	6.49

Source: Company data; Bloomberg; Khambatta Research

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Lasa has three production units in Maharashtra – two in Khed and one in Mahad

Production animals account for close to two-thirds of the overall global veterinary pharma market

The global animal pharma market is 1/40th the size of the human pharma market

Company Profile

Lasa Supergenerics Limited (Lasa), a vertically-integrated active pharmaceutical ingredient (API) manufacturer specializing in 'catalyst chemistry', is India's leading player in veterinary API products. The company is present across four veterinary API product categories (including anthelmintics), other API products, animal feed ingredients, and reagents for therapeutic use while three more APIs are currently under development. Lasa has established alliances with leading participants in the animal healthcare market and employs Good Manufacturing Practice (GMP). The company sells its products in the domestic and international markets including China, Korea, Bangladesh, Pakistan, Australia, Turkey, Egypt, Jordan and other countries in the Middle East to over 300 customers. Approximately 16% of the company's sales came from exports in FY20. Lasa has production facilities in Mahad (1 unit) and Khed (2 units) in Maharashtra with an installed capacity of 4,300 MT. The facilities operate at 95% utilisation on average.

Lasa is led by a group of technocrats, spearheaded by its Chairman and Managing Director, Dr. Omkar P Herlekar under whose leadership backward integration of Lasa's operations was achieved. Dr. Herlekar holds a number of process patents to his credit.

Industry Overview

The veterinary pharma market can be broadly segmented into production (including livestock and poultry) and companion animals in terms of animal types. The market for production animals is the larger segment of the veterinary pharma market, accounting for 62% of the overall market in 2017 (*source: Future Market Insights*), driven by high demand for high-quality protein and poultry meat. While the production animal segment is expected to witness brisk demand going forward, the companion animal segment too will see robust growth, driven by rising pet ownership.

The worldwide market for animal pharmaceuticals is 1/40th the size of the human pharma market according to the Animal Health Institute (AHI), an industry trade group. AHI estimates that 24 billion chickens, over 1 billion cattle and sheep, 750 million pigs and goats, 500 million dogs and 400 million cats benefit from innovations in animal health across the globe.

Growing preference for animal protein-based food and an increase in incidences of zoonotic and food-borne diseases are responsible for increasing demand for vaccines and advanced pharmaceutical products for animals. Zoonotic diseases are transmitted from animals to humans through contaminated food and water, exposure to pathogens during handling, processing or cooking contaminated meat or dairy produce, or by direct contact with infected animals or humans. Contagious zoonotic pathogens such as the avian flu, H1N1 and SARS-CoV-2 viruses, bacteria and other microbes not only pose a threat to farm output and profitability but some of these infections get passed on to humans to cause disease in them. This has

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The global animal healthcare market is forecast to grow at a CAGR of 5.8% during 2020-2027

resulted in the veterinary pharma industry undertaking greater efforts to mitigate pathogen contamination risks and control food-borne diseases, contributing to the growth of the animal healthcare market. Valued US\$ 47.1 bn in 2019, the global animal healthcare market is expected to expand at a CAGR of 5.8% during 2020-27 (source: Grand View Research).

The key segments of the animal healthcare market in terms of product categories are vaccines, parasiticides, anti-infectives, anti-inflammatories, medical feed additives, and other therapeutics. While the industry and governments work closely to develop vaccines to protect against major outbreaks of diseases in production animals, advances in vaccine development is attributable to initiatives of animal welfare associations and technology innovations. Of these, the anti-infective segment commands a significant market share, driven by high demand due to an ever-increasing prevalence of zoonotic diseases. Vaccines, parasiticides, anti-inflammatories, and drugs to improve mobility and quality of life in companion animals are also expected to grow at a healthy rate going forward.

As global population increases, there will be an increasing demand for food and consequent stress on delivery of food security. As a result, public and private initiatives to promote poultry and livestock farming for meat and dairy production will lead to increasing demand for animal health products. According to the UN Department of Economic and Social Affairs, the current global population of approximately 7.3 billion is anticipated to reach 9.7 billion by 2050. With this expansion of the global population, 795 million people are forecast to be undernourished as estimated by the International Fund for Agricultural Development (IFAD).

India has the highest zoonotic disease burden amongst developing economies

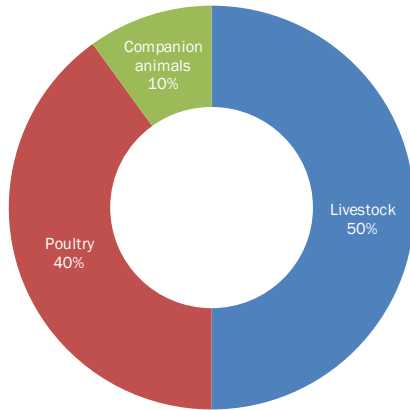
According to a study by the International Livestock Research Institute (ILRI), 27% of India's livestock showed signs of food-borne bacterial infections. With India having the highest zoonotic disease burden amongst developing economies with high incidences of both morbidity and mortality, the Indian veterinary healthcare market is expected to see healthy growth going forward.

In terms of end-use, the Indian animal healthcare market is dominated by production animals, accounting for 90% of the market (50% livestock + 40% poultry) with remainder 10% attributable to companion and other animals according to the Indian Federation of Animal Health Companies (INFAH). INFAH further estimates the market mix in terms of product categories as 40% feed supplements, 17% antibiotics, 15% biosecurity, 13% anti-parasitics, 5% hormones and biologicals, and 12% other categories. With approximately 50 major players operating in the Indian animal healthcare sector, the market is dominated by the top 10 players.

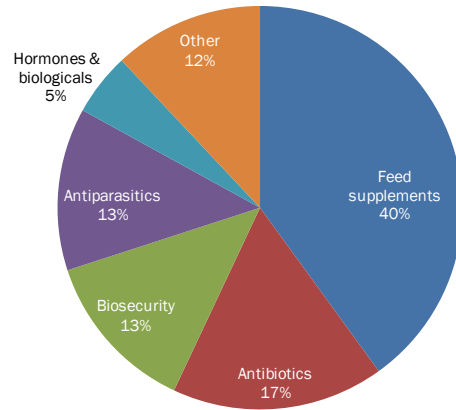
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Indian animal healthcare market split by animal type



Indian animal pharma market mix by product category

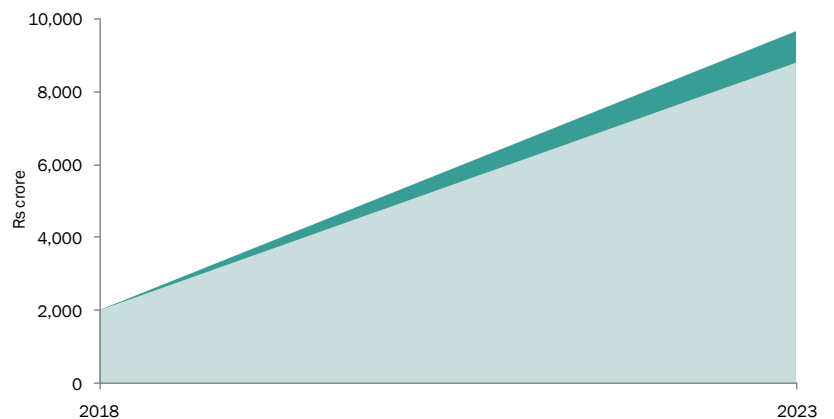


Source: INFAH

The Indian animal healthcare market is forecast to expand at a CAGR of 8-10% from 2018 to 2023

The Indian animal healthcare market stood at approximately Rs 6,000 crore in 2018 with the INFAH forecasting it to increase at a CAGR of 8-10% between 2018 and 2023. In terms of animal types, the market for livestock is expected to grow by 12-15%, poultry 8-10%, companion animals 18-20% and others 8-10%. The INFAH's growth forecast for the overall market is primarily attributable to solid growth of the livestock segment, driven by healthy consumption demand, technology interventions, and emerging risk of diseases of economic and zoonotic significance.

Indian animal healthcare market size and growth forecast



Source: INFAH

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Most veterinary pharma players in India are divisions of big diversified pharmaceutical companies

Peer Group

Most veterinary pharma players in India are divisions of large pharma companies with product portfolios comprising categories across human and animal pharmaceutical products. There are few listed pureplay animal pharma companies in India. We have considered three listed peers for Lasa, which operate predominantly in the veterinary healthcare market.

Sequent Scientific: Founded in 2002, Sequent’s animal healthcare business operates under the brand name “Alivira Animal Health” in the API and formulations domains. With R&D and manufacturing capabilities, the company’s targeted therapies include anthelmintics, anti-protozoals, nutraceuticals, nonsteroidal anti-inflammatory drugs (NSAIDs), anti-infectives and dermatology. Sequent’s other business division Sequent Research provides research and analytics support to API, pharmaceutical, personal care and nutraceutical companies,

Hester Biosciences: Founded in 1987, Hester is India’s second largest poultry vaccine manufacturer. Having R&D and manufacturing capabilities, the Ahmedabad-based company operates Asia’s largest single-location animal biological manufacturing facility. Through its presence across the four verticals of poultry vaccines, animal vaccines, poultry health products, and animal health products, Hester’s product portfolio comprises over 50 vaccines and 35 health products.

Venky’s India: Established as Venkateshwara Hatcheries in 1971, Venky’s and its parent VH Group have diversified into poultry pharma and other related product lines. Although a majority of the company’s revenues is derived from poultry, followed by oilseeds, Venky’s also manufactures animal healthcare products. We have considered the company in our peer group analysis because its main line of business is an end market for the animal veterinary healthcare sector.

Peer Comparison: Key Financials Metrics, FY20

Rs crore	Lasa	Sequent	Hester	Venky's*
Revenue	167.3	1,179.2	183.3	3,043.1
EBITDA	29.9	170.3	55.6	309.1
EBITDA margin	17.9%	14.4%	30.3%	10.2%
PAT	3.6	82.0	31.0	174.1
PAT margin	2.2%	7.0%	16.9%	5.7%
Diluted EPS (Rs)	1.35	2.85	36.44	123.62
ROCE	8.2%	22.6%	13.7%	25.2%
ROE	2.6%	11.3%	16.4%	21.7%

*FY19 numbers as the company reported losses from the operating level onwards in FY20
 Source: Bloomberg; Khambatta Research

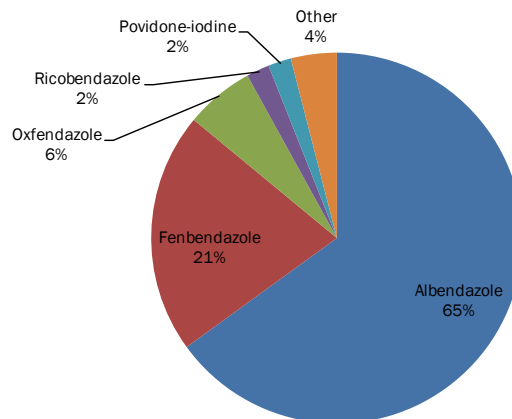
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Investment Thesis

A varied product mix with focus on animal healthcare renders Lasa the benefits of both diversification and niche play; lower price control in animal pharma supports margins. Lasa offers products across four categories – veterinary API products; animal feed ingredients; other API products; and reagents for therapeutic use. While the company’s presence across the animal and human API markets makes it a diversified API player, its focus on veterinary APIs and presence in the animal feed market make it a niche play, especially when most major animal healthcare players are part of bigger diversified pharma companies that are predominantly into the manufacture of human pharma products. Further, there is lower pricing control in animal pharma compared to human pharma with most customers of animal healthcare products being farm and pet owners, thereby making price control less justified. This enables higher operating margins for companies that operate predominantly in the animal healthcare space. Lasa’s top products include Albendazole, Fenbendazole, Nitroxylnil, Oxfendazole, Toldimphos Sodium, Halquinol (all veterinary APIs) and Povidone-iodine (a broad-spectrum antiseptic).

Revenue split by molecule (FY20)



Source: Company data

India’s livestock population of 53.6 lakh is the world’s largest

India’s world-leading production and consumption of animal-based food, and low livestock productivity present strong opportunities for vet pharma. At a population of 53.6 lakh, India has the world's largest number of livestock animals. The country also has the largest buffalo population of 11 crore. With a cattle population of 19.2 crore, India’s total bovine population stood at 30.3 crore in 2019. (Source: 20th Livestock Census, 2019). The world's largest milk producer (18.8 crore tonnes, approximately a fifth of world production) (source: National Dairy Development Board), India also is the world’s second largest poultry market with an annual production of over 7,500 crore eggs and over 19 lakh tonne poultry meat (source: Ministry of

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Food Processing Industries). That being said, India faces challenges in livestock productivity. The average annual milk yield of Indian cattle of 1,172 kg is approximately 50% of the global average as frequent outbreaks of diseases such as foot and mouth disease, black quarter infection and influenza affect livestock health leading to lower levels of productivity (source: *Livestock Sector in India: Trends, Challenges and a way forward*, Professor A M Paturkar. www.agrospectrumindia.com). According to the OECD-FAO Agricultural Outlook 2018-2027, India's per capita milk consumption of 84.4 kg/year was 53% higher than the global average and it is further expected to increase to 116.2 kg/year by 2027, a level that is forecast to be 87% higher than the world average. Given the ever-increasing demand for animal-based protein, it will be an imperative to increase livestock productivity in order to cater to India's rising per capita consumption of animal protein-based food. This will drive efforts and expenditure for the healthcare of production animals, which, in turn, will boost demand for veterinary pharma.

India's livestock and poultry markets

54 lakh



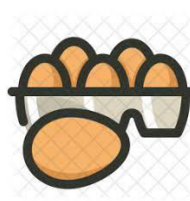
World's largest livestock population

19 crore tonnes



World's largest milk producer at 20% of annual world production

7,500 crore



World's second largest poultry market in terms of annual production of egg and poultry meat

19 lakh tonnes



Source: 20th Livestock Census, 2019; National Dairy Development Board; Ministry of Food Processing Industries

Increasing prevalence of zoonotic diseases will drive demand for veterinary API products. Zoonotic diseases are caused by infections originating in animals, which are subsequently passed on to humans. While some of these infections cause disease in animals, some others do not make animals ill but can cause disease in humans. Although zoonotic diseases have existed for centuries and caused pandemics and major outbreaks in the past centuries such as the plague and the Spanish flu (caused by an H1N1 virus), major known and novel zoonotic outbreaks have become more commonplace in the past few decades. Global population explosion and increasing urbanization have resulted in human invasions of natural habitats of wild animals, leading to easier transmission of zoonotic pathogens to humans.

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Zoonotic diseases including the SARS, MERS and COVID-19 coronavirus infections cause high levels of morbidity and mortality in humans

Illegal wildlife trade as well as mainstream production animal farming also pose risks of zoonotic disease transmission. The avian flu, the H1N1 swine flu, Ebola, Nipah virus infection, and new/emerging coronavirus diseases such as SARS, MERS and COVID-19 are amongst diseases of zoonotic origins causing high levels of morbidity and mortality in humans. Besides these, diseases like salmonellosis and rabies have become endemic across human communities. While significant efforts and funding are directed towards finding cures and developing vaccines for these diseases in humans, prevention and management of zoonotic diseases in livestock and poultry are extremely critical for mitigating the risk of major zoonotic disease outbreaks in human populations. As controlling zoonoses in animal populations is much more cost-effective and can help prevent human morbidity and mortality more effectively, efforts to eliminate zoonotic pathogens from their animal reservoirs is increasingly gaining importance. This will be an important driver for veterinary API products in the vaccine, anti-infective, parasiticide and biosecurity segments going forward.

Rising awareness about preventive animal healthcare and prudent use of antimicrobials in production animals will drive demand for animal vaccines.

Vaccination has emerged as one of the most widely-used animal healthcare products as besides preventing diseases they also mitigate the risk of antimicrobial overuse. Growing awareness amongst consumers regarding microbial residue levels (MRLs) in meat, poultry and dairy products, and increased demand for antibiotic-free products will drive demand for animal vaccines going forward. Rising pet ownership will further create incremental demand for veterinary vaccination.

Backward integration and a flexible manufacturing setup help Lasa generate cost advantages; strong R&D capability generates competitive advantage.

Lasa's backward integration and multi-use manufacturing facility renders flexibility to change the product mix in line with changing needs in end markets. The backward integration reduces dependence on vendors for key raw materials with the company manufacturing intermediates for Albendazole, Fenbendazole, Ricobendazole and Oxfendazole in its upstream manufacturing process, leading to mitigation of supply chain challenges and enabling greater control over cost and quality. The multi-use capability of the facilities, on the other hand, allows the company to cater to market segments with high prevailing demand without incurring additional capex as well as significantly reducing the lead time for switching between products, thereby generating cost advantages. Lasa's expertise in catalyst chemistry enables shorter cycle times, cost savings on raw materials, labour and power, increases productivity of manufacturing capacity, and reduces by-product and effluent discharge. Further, the company's active R&D programme looks to develop APIs with the objective of building a pipeline to drive future growth through new product launches. The R&D practice also strictly conforms to process research while striving to enhance existing processes to improve production with optimum utilization of resources. On the back of its R&D competence, Lasa has gained strong IP/patent certification capacity, which

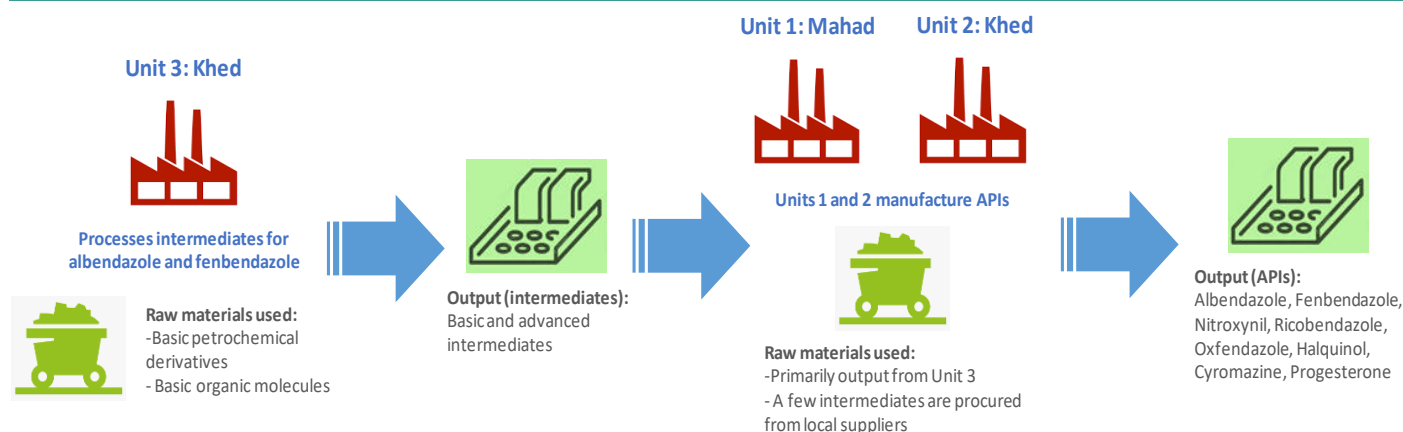
Lasa owns 6 process patents for APIs

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gives the company a competitive advantage. The company owns 6 process patents for APIs.

Manufacturing process with full backward integration



Source: Company data

Lasa has entered into collaboration with the Institute of Chemical Technology for synthesizing the Favipiravir molecule

Progesterone and COVID-19 drug Favipiravir present new growth avenues, especially in the wake of the coronavirus pandemic. Lasa has received approval for the commencing production of the female sex hormone Progesterone. With supply chain disruptions in the wake of the COVID outbreak and India's endeavour to reduce dependence on Chinese imports, Lasa is amongst a handful of global players engaged in the manufacture of the synthetic version of the hormone. Further, Lasa has established a collaboration with the India's Institute of Chemical Technology (ICT) for manufacturing the antiviral Favipiravir, one of the drugs currently being used for treating COVID-19 in India and other countries. Originally developed to treat influenza, Favipiravir can potentially inhibit other RNA viruses such as the ones causing yellow fever and chikungunya. Lasa expects to be able to sell the drug at a lower price based on ICT's technology for synthesizing the molecule. Currently the company is looking to secure regulatory permissions to commence production of the drug.

Valuation

At 13.0x FY22E EPS of Rs 6.49, we rate Lasa a BUY with a target price of Rs 84 and an upside potential of 44%. Lasa reported stable revenues and solid margin expansion in FY20 followed by robust revenue and margin growth in 1Q FY21. We have modelled robust topline growth during FY21 in line with the solid performance reported in 1Q FY21. We expect FY22 revenue growth to normalize but still remain healthy. The strong revenue growth is expected to generate operating leverage, leading to margin expansion from the operating level through the PAT level with incremental growth in PAT margin as interest expense falls with declining debt levels. ROCE and ROE are expected to see solid gains as a result. Basis strong earnings growth forecast, the Lasa stock trades at very attractive forward P/E

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At current price the Lasa stock trades at attractive forward P/E levels of 11.4x FY21E EPS and 9.0x FY22E EPS

levels of 11.4x and 9.0x FY21E EPS and FY22E EPS, respectively. The expected expansion of return ratios will make Lasa's profitability more comparable to that of the other companies in our peer group. Valuing at 13.0x FY22E EPS of Rs 6.49, our target price of Rs 84 informs a BUY rating with an upside potential of 44%.

Relative Valuation: Price-to-Earnings (FY16 to date)

	High	Low	Average	Current
Lasa Supergenerics	47.2	3.2	9.8	43.4
Sequent Scientific	49.1	21.5	34.5	46.0
Hester Biosciences	70.9	19.1	37.7	40.8
Venky's India	48.7	5.0	21.5	N/A

Note: Multiples from FY16 onwards or since listing (excluding negative earnings periods)

Source: Bloomberg

1Q FY21 Financial Performance

Rs lakh	1Q FY20	4Q FY20	1Q FY21	Y-o-y	Q-o-q
Operating revenue	3,898	4,859	5,460	40.1%	12.4%
EBITDA	503	903	1,218	142.1%	34.9%
EBITDA margin	12.9%	18.6%	22.3%	940 bps	373 bps
PAT	(108)	258	537	N/A	108.3%
PAT margin	-2.8%	5.3%	9.8%	1260 bps	453 bps
Diluted EPS (Rs)	(0.47)	0.89	1.32	N/A	48.3%

Source: Company data; Bloomberg; Khambatta Research

Profit & Loss Account

Rs lakh	FY18A	FY19A	FY20A	FY21E	FY22E
Revenue from operations	24,584	16,957	16,727	22,046	24,758
Growth		-31.0%	-1.4%	31.8%	12.3%
Cost of production and operations	20,451	15,846	13,732	17,284	19,361
EBITDA	4,133	1,111	2,995	4,762	5,397
EBITDA margin	16.8%	6.6%	17.9%	21.6%	21.8%
Depreciation & amortization	1,817	1,931	1,734	1,549	1,687
PBIT	2,658	(408)	1,284	3,235	3,735
Interest expense	1,134	1,202	810	502	289
PBT	1,523	(1,610)	474	2,733	3,446
Tax expense	289	(407)	111	639	806
PAT	1,234	(1,203)	363	2,094	2,640
PAT margin	5.0%	-7.1%	2.2%	9.5%	10.7%
Diluted EPS (Rs)	5.40	(5.26)	1.35	5.15	6.49

Source: Company data; Bloomberg; Khambatta Research

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Abridged Balance Sheet

Rs lakh	FY18A	FY19A	FY20A	FY21E	FY22E
Total shareholders' equity	11,734	10,530	14,147	16,240	18,880
Total debt	10,666	8,460	4,841	3,391	1,351
Trade payables	4,794	5,967	3,373	4,711	5,273
Total equity & liabilities	28,678	25,850	23,199	25,300	26,584
Property, plant & equipment	16,365	15,566	14,596	14,425	14,470
Intangible assets	624	628	623	680	714
Inventory	4,223	3,160	2,630	3,624	4,056
Trade receivables	4,215	2,888	2,065	2,718	3,052
Cash & cash equivalents	50	42	257	100	123
Total assets	28,678	25,850	23,199	25,300	26,584

Source: Company data; **Bloomberg**; Khambatta Research

Ratio Analysis

	FY18A	FY19A	FY20A	FY21E	FY22E
ROA	4.3%	-4.7%	1.6%	8.3%	9.9%
ROCE	14.8%	-2.7%	8.2%	19.0%	19.4%
ROE	10.5%	-11.4%	2.6%	12.9%	14.0%
Debt-to-equity ratio	0.9x	0.8x	0.3x	0.2x	0.1x

Source: Company data; **Bloomberg**; Khambatta Research

Key Risks

- Lasa's area of business is highly regulated and successful product launches as well as sale of existing products are subject to approvals and licences from several authorities across jurisdictions the company operates in.
- Lasa operates in a market that is dominated by big pharmaceutical companies which have stronger financial capacity, bargaining power and distribution outreach.
- Continued supply chain disruptions due to the COVID-19 pandemic can negatively affect Lasa's business.
- An extended economic downturn owing to / as a fallout of the COVID-19 pandemic may lead to underperformance of our forecasts.

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Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

Stock ratings

Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

Hold recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

Sell recommendations are expected to improve up to 5% or deteriorate, based on consideration of the fundamental view and the currency impact (where applicable).

Analyst Certification

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