Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Laurus Labs Ltd

Healthy Q1; growth outlook stays robust

Pharmaceuticals	Sharekhan code: LAURUSLABS
Reco/View: **Buy** ↔	CMP: **Rs. 525** / Price Target: **Rs. 735** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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 July 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. 20,582 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	12.0	-13.7	8.9	-15.2
Relative to Sensex	5.1	-12.5	9.5	-23.6

Sharekhan Research, Bloomberg

Summary

- Laurus Labs Limited (Laurus) reported healthy numbers in Q1FY23 that beat estimates, driven by impressive growth of the synthesis division.Revenue growth stood strong at 20.4% y-o-y, while reduction of tax sops drove up tax rate. Thus, PAT growth slowed down to 4.5%.
- Based on encouraging growth prospects, that are well-supported by capacity expansion plans, the management has retained its revenue guidance of $1 billion by FY2023E, that bodes well from a growth perspective
- Laurus has retained its capex guidance of Rs 2000 crore over the next two years with half of the capex directed towards synthesis segment, while the balance would cater to other segments.
- We retain a Buy on Laurus with an unchanged PT of Rs. 735.

Laurus Labs Limited (Laurus) reported healthy numbers in Q1FY23 that beat estimates, driven by impressive growth of the synthesis division. Meanwhile, API sales grew by a modest 6% y-o-y and finished dosages (FD) segment sales declined, owing to weak ARV sales. Revenue growth stood strong at 20.4% y-o-y, while reduction of tax sops drove up tax rate. Thus, PAT growth slowed down to 4.5%. 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 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 staged an impressive 196% y-o-y growth to Rs 577 crore.
- The ARV-API sales staged a 28% q-o-q growth pointing at a possible improvement

Key negatives

- FD segment sales declined by 33% y-o-y impacted by lower ARV sales.
- OPMs contracted by 141 bps y-o-y on the back of elevated cost pressures with other expenses / sales increasing by 240 bps y-o-y.

Management Commentary

- Laurus sees the synthesis segment as a key growth driver and the expects growth to be driven by client additions, increased business from existing clients and capacity expansion. Share of revenues from synthesis segment is expected to increase to one-third by FY2025.
- Laurus is emphasising on the non-ARV business for growth ahead. Further, it has commissioned its 10 bn tablet per year FD capacity and expects full utilization by year-end. Consequently, it has retained its $1 billion revenue guidance for FY23E
- Laurus is witnessing a strong demand traction and in order to cater to the demand it has retained its capex guidance of Rs 2000 crore over the next two years. Around half of the capex is earmarked for the synthesis segment, while the balance would cater to other segments and backward integration.

Revision in estimates – Q1FY23 was a healthy quarter for Laurus and the results are ahead of estimates. Impressive performance by the synthesis segment is likely to partly make up for the weak performance of the FD segment. Basis this and encouraging commentary, we have largely retained our estimates for FY23E and FY24E.

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 FY2023E, that bodes well from a growth perspective. Citing strong demand environment, the management has retained its capex guidance and this provides comfort on growth ahead. Likely impressive performance of the synthesis segment, strong outlook of the FD segment and normalizing trends for API segment would be the key drivers for Laurus. At CMP, the stock trades at 22.9x/17.3x its FY23E/FY24E EPS, which provides ample headroom for expansion. We retain a Buy 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) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Sales	4813.5	4935.6	6897.4	8414.3
Operating Profits	1550.7	1422.4	2117.5	2701.0
OPM(%)	32.2	28.8	30.7	32.1
PAT	983.9	832.2	1222.2	1613.7
EPS	18.5	15.6	23.0	30.3
P/E	28.4	33.6	22.9	17.3
EV/EBIDTA	18.8	20.8	14.2	10.9
ROE (%)	37.9	24.8	26.7	26.1
ROCE (%)	32.2	21.6	26.4	27.6

Source: Company; Sharekhan estimates

Healthy Q1FY23: Laurus Labs reported healthy numbers for Q1FY23 with the synthesis division driving growth. Results were ahead of estimates. Sales at Rs 1538.9 crore grew strongly by 20.4% y-o-y and was ahead of estimates. Revenue growth was driven by a 196% y-o-y jump in the Synthesis division backed by increased offtake from customers. The FD segment sales declined by 33% y-o-y impacted by ARV segment sales. API segment sales grew by a modest 6% y-o-y pointing at a possible improvement. Operating profit grew 14.9% y-o-y to Rs 454 crore, while sequentially too, it rose 14.5%. OPM, at 29.5% (as against estimated 27.5%), contracted by 141 bps y-o-y attributable to an increase in the other expenses which rose 240 bps y-o-y (as a % of Sales). The gross margins expanded by 90 bps y-o-y. Tax rate stood higher at 29% v/s 23.6% in Q1FY22 due to change in SEZ profits exemption to 50% from FY 23 for the next five years. Therefore the PAT at Rs 252 cr grew at a slower pace of 4.5% y-o-y and was ahead of estimates of 238 cr.

Q1FY2023 Concall Highlights

- **Strong demand seen across Synthesis and FDF; Laurus retains $1bn topline guidance for FY23:** Laurus' synthesis business has staged a strong 196% y-o-y growth in the revenues for the quarter and the share of revenues from the synthesis business increased to 37% (FY22 - ~19%). Strong growth can be attributable to the sustained new client additions and increased business from existing clients and commencement of supplies to a global life sciences company. 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 the CDMO segment, considering strong demand. Traction from the existing customers, client additions and strong demand environment supported by capacity expansion plans are key factors to fuel the growth in the API segment. Generic FDF sales have been hit by a decline in ARV sales and the company has been taking efforts to improve the performance, especially on the tendering business front. Also the pricing pressures in the developed markets have impacted, but higher volumes have enable to offset the impact partly. In addition, Laurus has commissioned Unit-2 (FDF capacity has risen to 10 bn units per annum) brownfield expansion and the same is expected to ramp-up. Going ahead, the outlook is strong supported by a strong demand environment. As Laurus has a strong product pipeline in the US with 32 ANDA's filled and 74 DMFs. Backed by the commissioning of 4 fermenters each with a capacity of 45,000 kilolitres in FY22, revenues for FY23 would be fully reflecting the impact of new capacities. Overall, with the API segment sales improving and a robust outlook for other segments of FDF and synthesis. Consequently, the management has retained its revenues target of $1-billion by FY2023, which bodes well.
- **APIs showing shoots of a revival, management expects normalisation to commence as non ARV-API's drive growth:** API segment sales in Q1FY23 grew by a modest 6% y-o-y to Rs 583 crore. Backed by a strong growth in the other API and in Oncology API. ARV API performance has improved by 28% sequentially thus pointing at likely stabilisation phase 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 an 8.5% and 82% y-o-y growth for the quarter with a strong growth outlook backed by a strong order book. A low base for other APIs have resulted in a string growth of 82% y-o-y. Overall, Laurus expects the ARV API segment run-rate to be normalising in FY23 and sees the segment reviving, though the focus would be on non ARV API's for growth.
- **Laurus guides to spend 4% of topline for R&D:** For Q1Fy23 the company has incurred Rs 49 crore, or 3% of topline as R&D investments, while for FY22 and FY21 the company has incurred 4% of sales towards R&D investments. Also the company has strong product pipeline for developed markets, which includes 60%

allocation for Non ARV products and 40% towards ARV's. This this points towards the company's efforts to reduce the share of ARVs by increasing the share of non ARV products and this bodes well. Further the future R&D pipeline, which consists of many products offer a addressable market size of $48 billion, which is substantial. Going ahead the company plans to incur 4% of sales towards R&D expenses.

- **Capex guidance retained at Rs 2000 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 billion by FY2023, translating in to a strong topline growth. However, to capture the strong demand trends the company had announced a capex plan of Rs 2000 crore over the next two years. Laurus has already invested Rs. 208 crore in Q1FY23 and is track to invest the planned amount over the next two years. Overall, sturdy demand outlook supported by capacity expansion, addition of new therapy areas, in the non ARV space, 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:** Revenues from Laurus Bio stood at RS 30 cr as compared to Rs 14 cr in Q1FY22. 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's 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 ARV-API sales normalising with a possible gradual improvement expected in 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 in FY23 and 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. The company has planned to set up three new facilities dedicated for Synthesis division. Raw material availability and elevated raw material prices, higher logistics costs, the management expects the EBITDA margins to sustain at ~30% levels, which appear to be conservative in the light of the 29.5% OPM reported in Q1FY23.

Results (Consolidated) Rs cr

Particulars	Q1FY23	Q1FY22	y-o-y %	Q4FY22	QoQ %
Total Sales	1,538.9	1,278.5	20.4	1,424.8	8.0
Operating profit	454.2	395.4	14.9	396.7	14.5
Other income	1.8	5.9	-70.1	1.3	35.7
EBITDA	455.9	401.2	13.6	398.0	14.6
Interest	29.3	26.6	9.9	30.6	-4.3
Depreciation	70.8	58.5	20.9	65.7	7.7
PBT	355.9	316.1	12.6	301.7	18.0
Taxes	103.3	74.4	38.8	69.8	48.0
Adjusted PAT	252.5	241.6	4.5	231.9	8.9
Margins			**BPS**		**BPS**
OPM %	29.5	30.9	-141	27.8	167
Adj PATM %	16.4	18.9	-249	16.3	13
Tax Rate %	29.0	23.6	548	23.1	590

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), a 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 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 pharmaceutical companies.

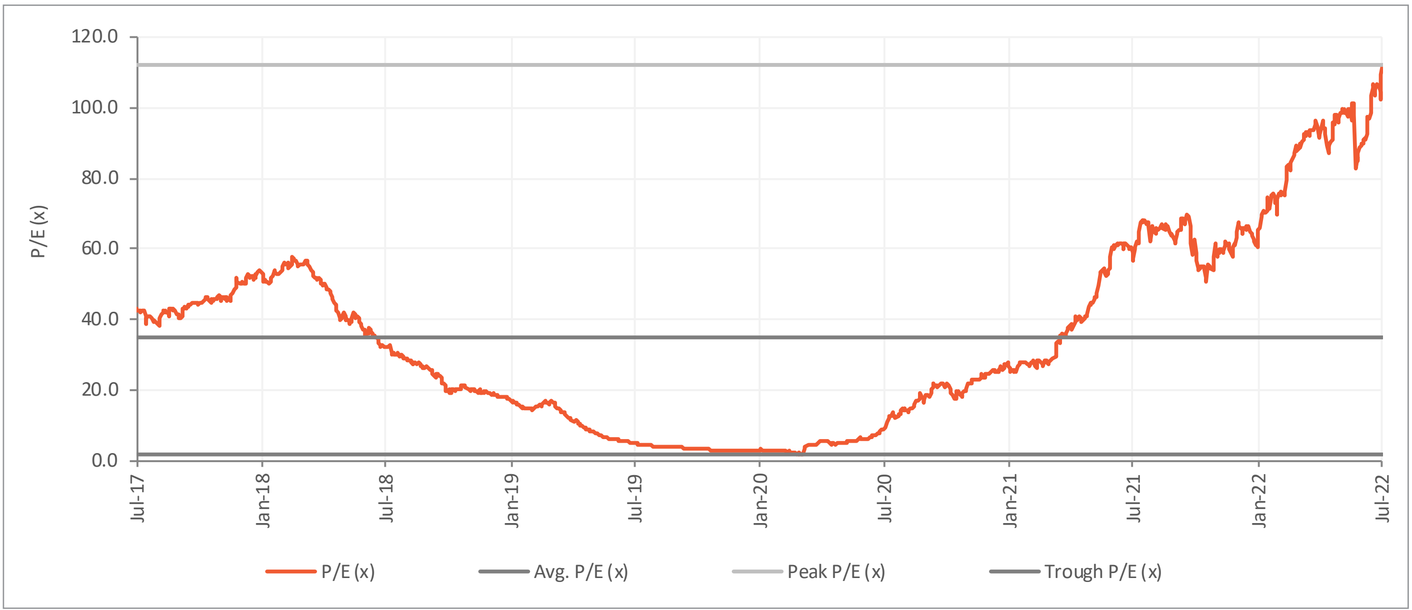
■ Company Outlook – Outlook – Strengthening prospects

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 has doubled 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 segment and in the process reduce 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, likely commercialisation of new products and capacity expansions. 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 ARVs and input costs pressures could act as transient issues, and the management has witnessed the green shoots of trend normalizing for the ARV business.

■ Valuation – Valuation: Retain Buy with unchanged PT of Rs. 735

Q1FY23 was a healthy quarter for Laurus and the performance was driven by an impressive show by the synthesis segment, supported by APIs, while FD sales declined owing to a fall in ARV sales. The management sees ARV-API trends to normalise and FY23 is likely to witness a revival in API sales. Backed by a strong product portfolio, capacity expansion plans, the FDF segment is likely to sustain the healthy growth trajectory. Considering the buoyant demand environment, the company has retained its capex guidance. Growth in business from existing customers, client additions and capex plans would be key drivers for the synthesis business. Q1FY23 was a healthy quarter for Laurus and the results are ahead of estimates. The impressive performance from the Synthesis segment is likely to partly make up for the weak performance of the FD segment. Based on this and the encouraging commentary, we have largely retained our estimates for FY23E and FY24E. At CMP, the stock trades at 22.9x/17.3x 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	525.0	53.2	20,582	33.6	22.9	17.3	20.8	14.2	10.9	24.8	26.7	26.1
Granules	299	45.3	7,423	17.9	14.8	11.7	11.2	9.0	7.2	16.0	16.8	18.2
Divis Labs	3847	3.5	102126	34.5	33.5	29.2	24.9	23.1	19.9	25.2	21.5	20.5

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

1. Slower-than-expected ramp-up in formulations, API or custom synthesis businesses.
2. 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 as on March 25, 2022

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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