

NOVEMBER 28, 2022

CHANGE IN RECO.

Sector view: **Neutral**

CMP (₹): 450

Fair Value (₹): 350

BSE-30: 62,505

Castle in the sky. We believe Laurus' troubles on ARV pricing and looming cessation of Paxlovid sales are being underappreciated. Ex-Paxlovid, it reported just a ~19% EBITDA margin in 1HFY23. Even as volumes pick up, Laurus' ARV realization will stay under pressure, as it bids for winner-takes-all tenders and lower long-term tender prices. As Paxlovid sales recede, the true extent of the margin hit will unravel. Our revised FY2024E EPS is 34% lower than the Street. Downgrade to SELL with an FV of Rs350.

Laurus Labs				Forecasts/valuations		
Stock data				2023E	2024E	2025E
CMP(Rs)/FV(Rs)/Rating	450/350/SELL			16.9	14.8	20.1
52-week range (Rs) (high-low)	626-433			9.4	(12.3)	35.8
Mcap (bn) (Rs/US\$)	242/3			26.6	30.4	22.4
ADTV-3M (mn) (Rs/US\$)	670/8			5.7	4.8	3.9
Shareholding pattern (%)				EV/EBITDA (X)	15.2	16.4
Promoters	27.3			RoE (%)	21.3	15.7
FPIs/MFs/BFIs	22.7/5.5/3.5			Div. yield (%)	0.0	0.0
Price performance (%)				Sales (Rs bn)	63	65
Absolute	1M	3M	12M	EBITDA (Rs bn)	17	16
Rel. to BSE-30	(3.0)	(26.8)	(23.4)	Net profits (Rs bn)	9	8

Source: Bloomberg, Kotak Institutional Equities estimates

Recent South African ARV tender sees significant reduction in pricing

Laurus' ARV dependence still remains elevated (35% in 1HFY23, despite high Paxlovid mix). As seen in the recent South African tender (South Africa is the biggest buyer of ARVs in the world), prices of ARV formulations are down 12-53% versus the previous three-year contract (Exhibit 1), while manufacturers looked to secure supplies amid higher competition. We note Laurus will be eligible to bid for this tender only in the next cycle in CY2025. However, results of the Global Fund and PEPFAR tenders are expected anytime now, and as seen in the past, there is a high chance of their pricing mirroring the South African tender. The company does also supply ARV APIs to few formulation companies that bid for the South African tender.

Meaningful downside risk to Street forecasts

In our view, excluding Paxlovid (~US\$125 mn Paxlovid intermediate sales in 1HFY23), Laurus has reported a meager ~19% EBITDA margin in 1HFY23 compared with the Street's expectation of ~30% each in FY2024/25E. Additionally, we highlight Paxlovid sales have dropped to almost nil over the past two months. We agree that as ARV volumes pick up and Laurus adds further CDMO projects (KIE: 40% ex-Paxlovid CDMO sales CAGR over FY2023-25E), core margins will pick up from 2Q levels. Accordingly, we are also building in a recovery to 24.4%/27.0% EBITDA margins in FY2024/25E. However, the extent of recovery being factored in by the Street is quite elevated and susceptible to downward revisions.

Margins at risk; downgrade to SELL with reduced FV of Rs350

Laurus has witnessed severe pricing pressure and lower volumes in its ARV formulations portfolio for five quarters now, resulting in significant pressure on core margins. Once Paxlovid contribution recedes in 2HFY23, the impact of lower ARV pricing should start reflecting in weaker overall margins, despite some respite hereon from higher capacity utilization, lower RM prices and backward integration initiatives. We lower the FY2023-25E EPS by 12-28% owing to further reduction in ARV sales and lower Paxlovid sales with lower gross margins. At CMP, the stock is trading at an expensive ~30x FY2024 EPS. We have kept the target multiple unchanged at 20x Sep 2024E EPS, as a faster-than-expected decline in ARV contribution will indirectly result in higher CDMO contribution. Downgrade to SELL with a lower FV of Rs350 (Rs460 earlier).

QUICK NUMBERS

- ARV formulation prices have reduced 12-53% in the recent South African ARV tender
- We are building in 24.4%/27.0% EBITDA margins in FY2024/25E
- Our revised FY2024E EPS is 34% lower than the Street

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Global Fund and PEPFAR wins factored in, even as SA outcome is worrying

With 8 mn people in South Africa (SA) being infected by HIV—out of which over 5.5 mn people are receiving treatment—SA is the biggest buyer of ARVs in the world. As seen in the recent SA tender (SA is the biggest buyer of ARVs in the world), prices of ARV formulations are down 12-53% versus the previous 3-year contract (Exhibit 1), while manufacturers looked to secure supplies amid higher competition. TLD is the WHO-recommended regimen that is the preferred first-line treatment for adults living with HIV, and hence, prescribed to most new patients; this regimen reported a price drop of over 31% from ZAR99 to ZAR68. We note that Laurus' ARV formulations segment is not directly impacted by this, as it will be eligible for the SA tender only in the next tendering cycle in June 2025. However, the company does supply ARV APIs to few formulation companies that bid for the SA tender.

Exhibit 1: SA's latest 3-year ARV tender saw significant price reductions
Pricing variance according to old and new contracts, June year-ends, 2022-25 (ZAR, %)

	Price as of new contract (ZAR)	Price as of old contract (ZAR)	Variance (%)
Contract pricing			
DTG 50	27	57	(52.7)
ABC/3TC 600/300	106	166	(36.1)
TLD 28S	68	99	(31.2)
ABC 60	38	51	(26.1)
ABC 240 ML	63	83	(25.0)
TE	52	69	(23.7)
TEE 28S	80	103	(22.5)
AZT/3TC 300/150	79	98	(19.1)
AZT 100	54	66	(17.9)
3TC 150	29	35	(17.7)
EFV 600	39	47	(16.7)
LPV/R 100/25	66	77	(13.8)
TDF 300	35	40	(11.7)

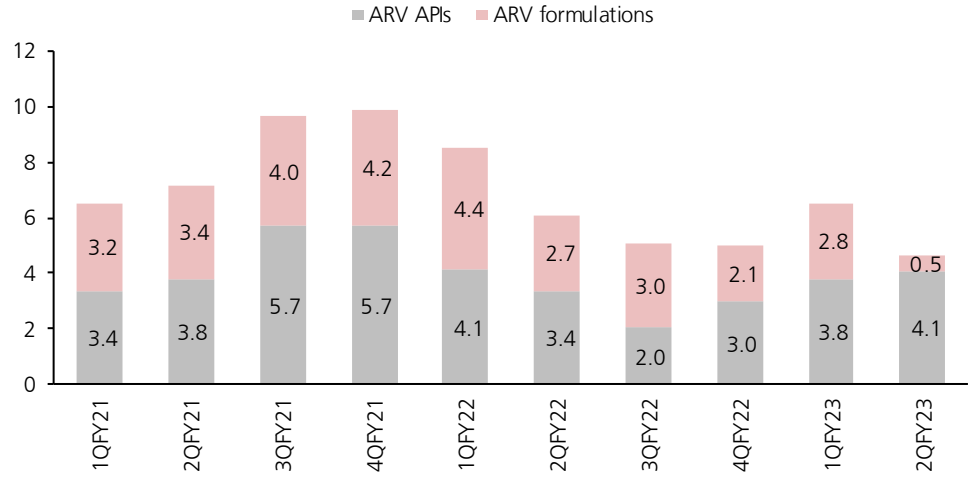
Source: South African Department of Health, Kotak Institutional Equities

For Laurus, PEPFAR and Global Fund are the key tenders. Laurus' ARV formulation sales were impacted in 2QFY23 due to less contribution from long-term tenders and inability to win short-term winner-takes-all tenders. In a normal year, PEPFAR and Global Fund constitute 75-80% of Laurus' ARV supplies (includes both API and formulations), with PEPFAR having a slightly higher contribution than the Global Fund. However, in the past, pricing for the Global Fund, PEPFAR and SA tenders has been largely in sync with each other. Though the results of the Global Fund and PEPFAR tenders are expected anytime now, there is a high chance of their pricing mirroring the modest prices seen in the SA tender. We highlight that we are still building in 25% yoy growth in ARV formulation sales for Laurus in FY2024, which factors in higher volumes from its likely wins in the Global Fund and PEPFAR.

Laurus not fully prepared yet to counter declining ARV contribution

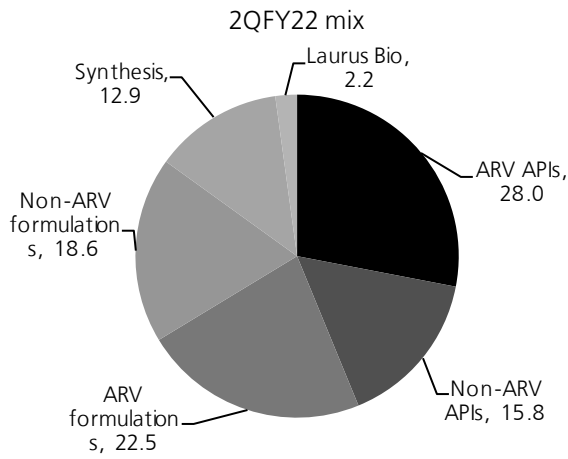
The company's ARV dependence still remains elevated (35% in 1HFY23, despite high Paxlovid mix). Laurus has witnessed severe pricing pressure and lower volumes in its ARV formulations portfolio for five quarters now, resulting in significant pressure on core margins. We highlight the company's ARV pricing was down 30+% yoy in 2QFY23. Laurus was also impacted, as it did not adjust its pricing and lost several short-term tenders. The company has since recalibrated its pricing and is now at par with the competitive pricing environment. Even as this will boost volumes hereon, we caution Laurus' ARV realization will stay under pressure, as it incrementally bids for lower-priced winner-takes-all tenders and encounters the impact of lower Global Fund and PEPFAR prices. Once Paxlovid's contribution recedes in 2HFY23, the impact of lower ARV pricing should start reflecting in weaker overall margins, despite some respite hereon from higher utilization, lower RM prices and backward integration initiatives.

Exhibit 2: Laurus' ARV formulation sales have dropped meaningfully over the past 5 quarters
 ARV sales split, March fiscal year-ends, 2021-23 (Rs bn)



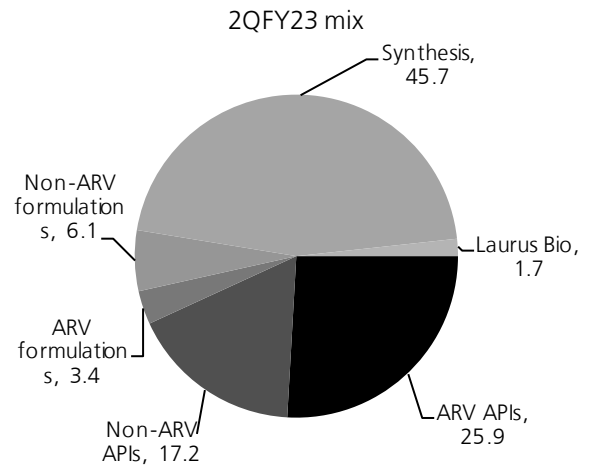
Source: Company, Kotak Institutional Equities

Exhibit 3: ARV contribution stood at 50% sales in 2QFY22
 Revenue mix, March fiscal year-end, 2022 (%)



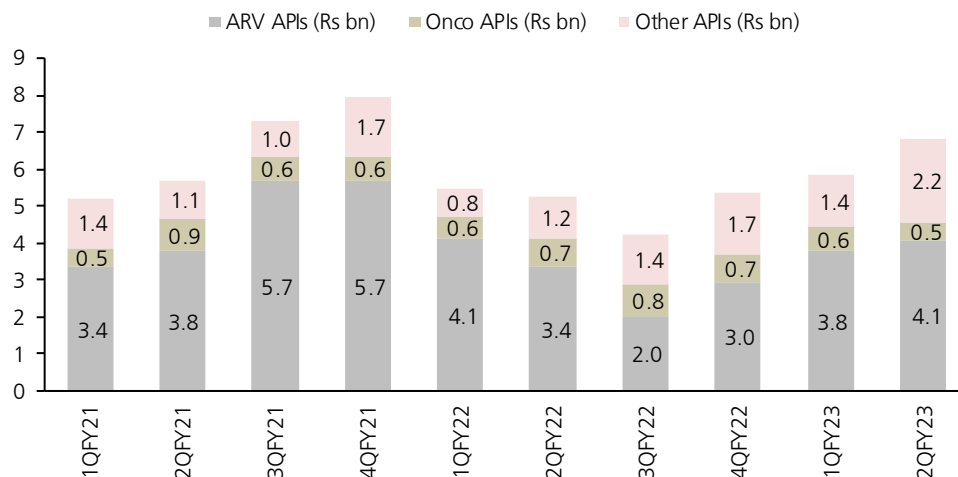
Source: Company, Kotak Institutional Equities

Exhibit 4: ARV contribution stood at 30% sales in 2QFY23
 Revenue mix, March fiscal year-end, 2023 (%)



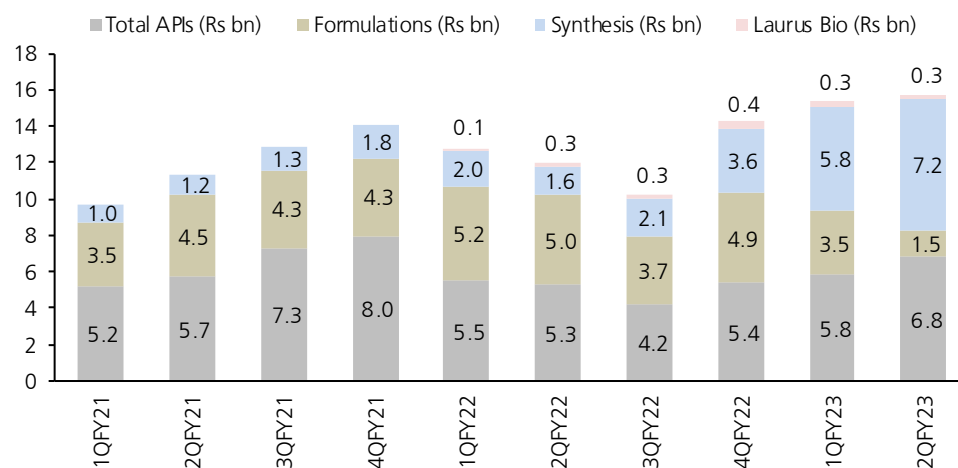
Source: Company, Kotak Institutional Equities

Exhibit 5: ARV API sales were up 8% qoq in 2QFY23
Laurus' API quarterly mix, March fiscal year-ends, 2021-23 (Rs bn)



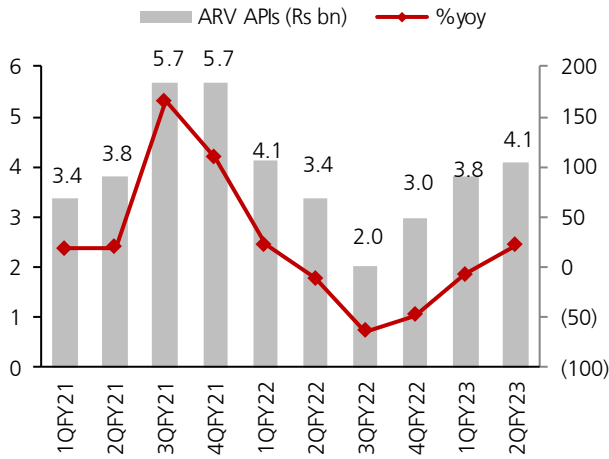
Source: Company, Kotak Institutional Equities

Exhibit 6: Led by Paxlovid, Synthesis reported 25% qoq growth in 2QFY23
Laurus' quarterly revenue mix, March fiscal year-ends, 2021-23 (Rs bn)



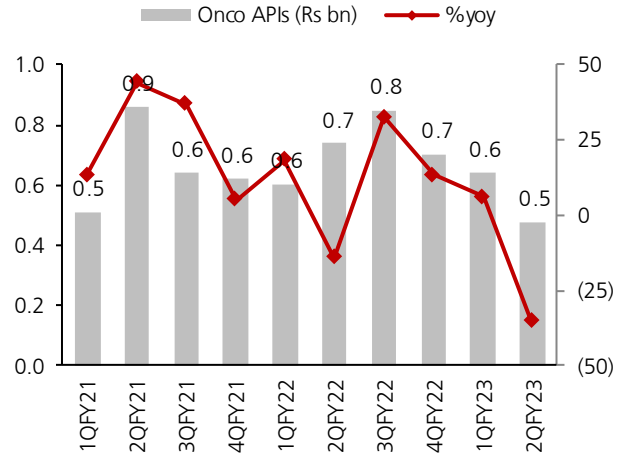
Source: Company, Kotak Institutional Equities

Exhibit 7: ARV API sales recovered in 2QFY23 to Rs4.1 bn
ARV APIs and growth, March fiscal year-ends, 2021-23 (Rs bn, %)



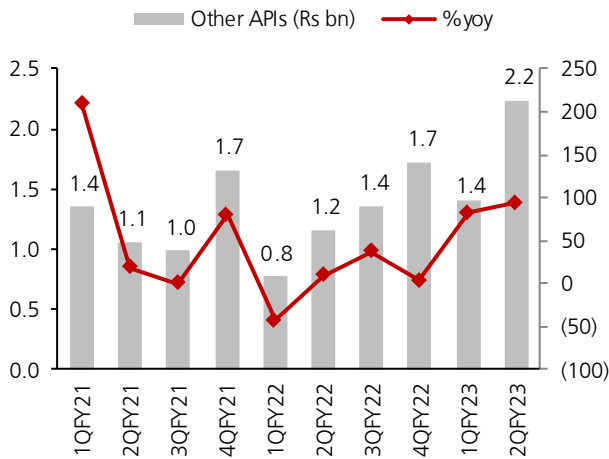
Source: Company, Kotak Institutional Equities

Exhibit 8: Onco API sales declined 36% yoy in 2QFY23
Onco APIs and growth, March fiscal year-ends, 2021-23 (Rs bn, %)



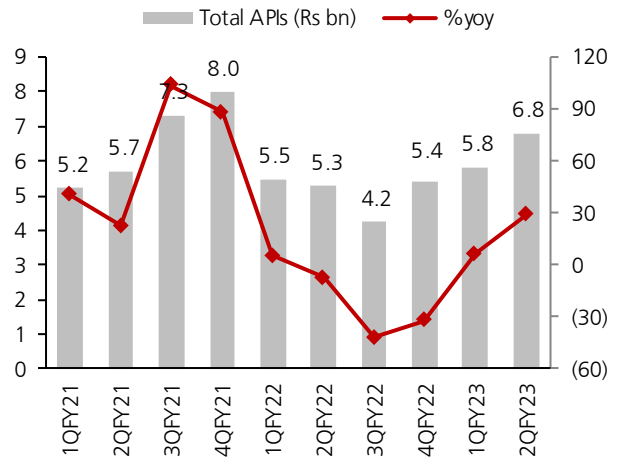
Source: Company, Kotak Institutional Equities

Exhibit 9: Other API sales grew 93% yoy in 2QFY23
Other APIs sales & growth, March fiscal year-ends, 2021-23 (Rs bn, %)



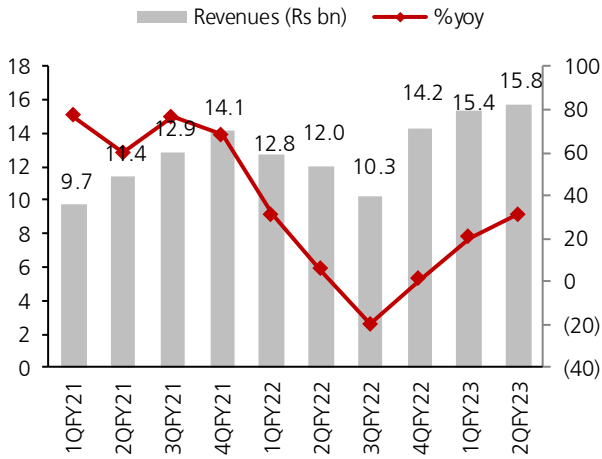
Source: Company, Kotak Institutional Equities

Exhibit 10: Total API sales grew 29% yoy in 2QFY23
Total APIs & growth, March fiscal year-ends, 2021-23 (Rs bn, %)



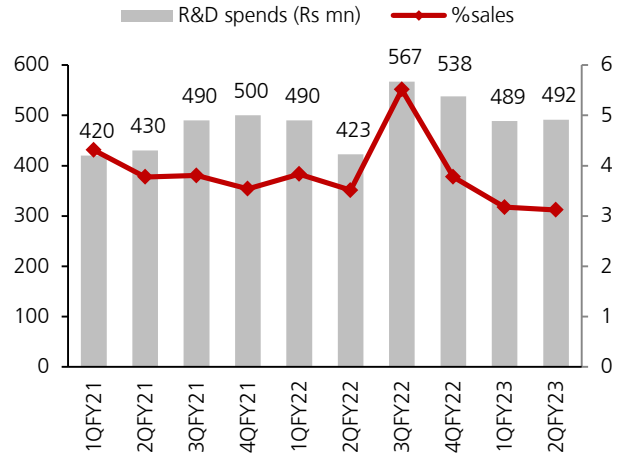
Source: Company, Kotak Institutional Equities

Exhibit 11: Laurus posted overall sales of Rs15.8 bn in 2QFY23
Laurus' quarterly sales, March fiscal year-ends, 2021-23 (Rs bn, %)



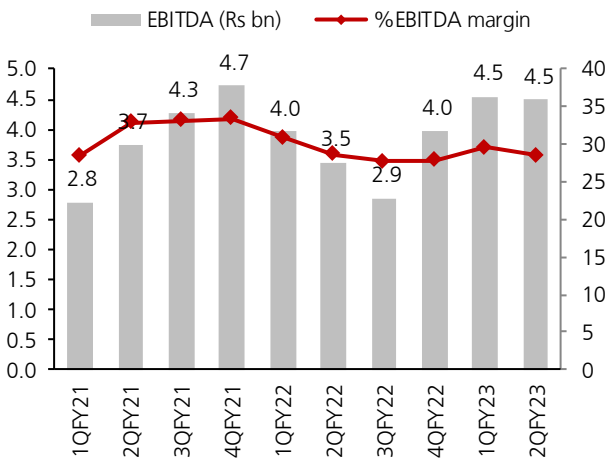
Source: Company, Kotak Institutional Equities

Exhibit 12: R&D spends (% of sales) fell to 3.1% in 2QFY23
Laurus' quarterly R&D, March fiscal year-ends, 2021-23 (Rs mn, %)



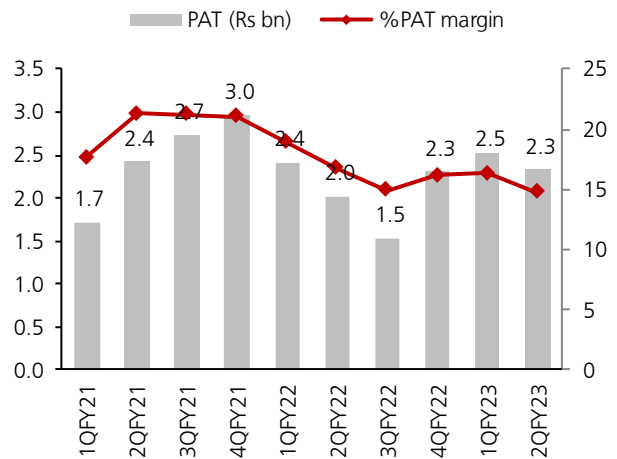
Source: Company, Kotak Institutional Equities

Exhibit 13: EBITDA margin declined to 28.5% in 2QFY23
Laurus' quarterly EBITDA, March fiscal year-ends, 2021-23 (Rs bn, %)



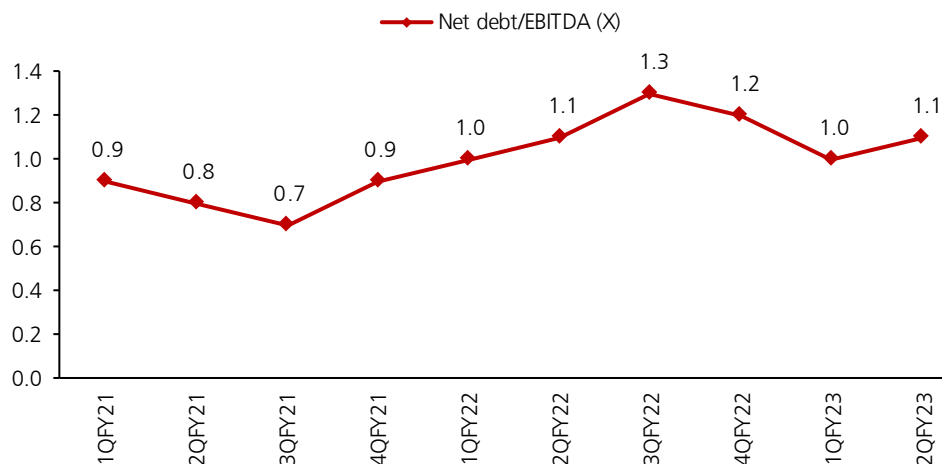
Source: Company, Kotak Institutional Equities

Exhibit 14: PAT grew 15% yoy in 2QFY23 to Rs2.3 bn
Laurus' quarterly PAT, March fiscal year-ends, 2021-23 (Rs bn, %)



Source: Company, Kotak Institutional Equities

Exhibit 15: We expect net debt/EBITDA to reduce hereon
Laurus' net debt/EBITDA, March fiscal year-ends, 2021-23 (X)



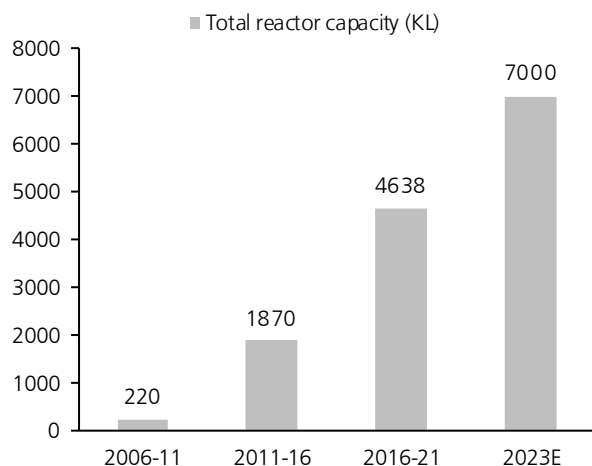
Source: Company, Kotak Institutional Equities estimates

Exhibit 16: Laurus has expansion plans lined up to augment growth in other APIs, FDFs and CDMO
Capacity expansion plans, March fiscal year-ends, 2023-25E

Division	Location	Status & Capacity	Operational
Formulation	Vizag	Unit 2 - 4 bn units (New building)	Completed
	Vizag	Unit 2 - 1 bn units (Debottlenecking)	Completed
	Hyderabad	Unit 9 - Land acquired	Phase 1 - FY2025
API	Vizag	Unit 3, 4 (1000 KL)	Completed
		Unit 4, 6 (1200+ KL) - under construction	FY2023
	Vizag	Unit 7, 8 - Land acquired	FY2024/25
Custom synthesis	Vizag	Unit 1 - LSPL	Completed
	Vizag	Unit 2, 4 (LSPL) - under construction	FY2024
	Vizag	Unit 3 (LSPL) - Land acquired	FY2024/25
	Hyderabad	R&D centre (LSPL) - under construction	FY2024

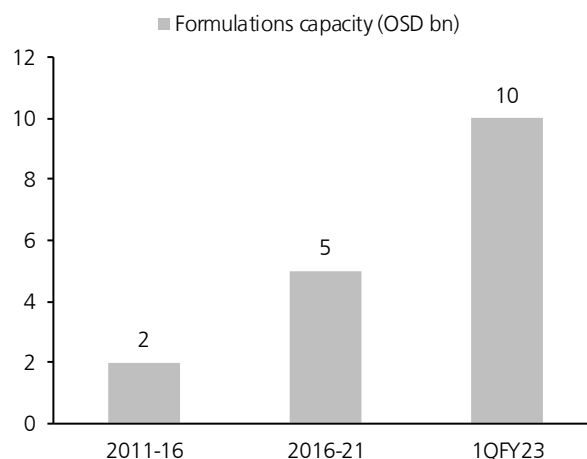
Source: Company, Kotak Institutional Equities

Exhibit 17: Laurus plans to ramp-up capacity significantly
Total reactor capacity, March fiscal year-ends, 2006-23E (KL)



Source: Company, Kotak Institutional Equities

Exhibit 18: Laurus' FDF annual capacity stands at 10 bn units
Formulations capacity, March fiscal year-ends, 2011-23E (OSD bn)



Source: Company, Kotak Institutional Equities

Exhibit 19: We reduce our EPS estimates by 12-28% on further reduction in ARV sales, lower Paxlovid sales with lower gross margins
Laurus' changes in estimates, March fiscal year-ends, 2023-25E (Rs mn, %)

	New estimates			Old estimates			Change (%)		
	2023E	2024E	2025E	2023E	2024E	2025E	2023E	2024E	2025E
Revenues	63,485	65,252	76,073	64,982	72,671	83,980	(2.3)	(10.2)	(9.4)
Gross profit	35,157	35,564	42,521	36,824	40,170	47,446	(4.5)	(11.5)	(10.4)
Gross margin (%)	55.4	54.5	55.9	56.7	55.3	56.5	-129 bps	-77 bps	-60 bps
EBITDA	16,986	15,925	20,563	18,553	20,032	24,344	(8.4)	(20.5)	(15.5)
EBITDA margin (%)	26.8	24.4	27.0	28.6	27.6	29.0	-180 bps	-316 bps	-196 bps
PAT	9,056	7,946	10,789	10,277	11,018	13,618	(11.9)	(27.9)	(20.8)
EPS	16.9	14.8	20.1	19.2	20.6	25.4	(11.9)	(27.9)	(20.8)

Source: Company, Kotak Institutional Equities estimates

Exhibit 20: We forecast sales CAGR of 15.5% for Laurus over FY2022-25E
Laurus' revenue breakup, March fiscal year-ends, 2023-25E (Rs mn, %)

	2016	2017	2018	2019	2020	2021	2022	2023E	2024E	2025E
Revenues (Rs mn)										
Anti-virals	14,590	14,721	15,311	15,144	10,863	18,520	12,488	15,940	17,338	17,295
ARVs	12,619	12,212	13,655	15,144	10,863	18,520	12,488	15,623	17,018	16,967
Hep-C	1,971	2,509	1,655	—	—	—	—	318	320	328
Oncology	1,413	1,073	1,655	2,182	2,106	2,630	2,893	2,919	3,356	3,685
Other APIs	513	1,498	1,655	2,101	3,245	5,060	5,010	6,265	7,644	9,019
APIs	16,517	17,292	18,621	19,427	16,214	26,210	20,390	25,125	28,337	30,000
Synthesis and ingredients	1,300	1,627	2,069	2,947	3,850	5,190	9,168	23,803	16,103	22,267
Synthesis	835	1,015	1,448	2,947	3,850	5,190	9,168	22,666	14,796	20,763
Ingredients	465	612	621	—	—	—	—	1,137	1,308	1,504
Formulations	—	—	89	546	8,253	16,640	18,800	13,236	19,201	20,586
Laurus Bio (Richcore)	—	—	—	—	—	—	1,001	1,320	1,610	3,221
Total revenues	17,817	18,919	20,779	22,920	28,317	48,040	49,359	63,485	65,252	76,073
As % of revenues										
Anti-virals	81.9	77.8	73.7	66.1	38.4	38.6	25.3	25.1	26.6	22.7
Oncology	7.9	5.7	8.0	9.5	7.4	5.5	5.9	4.6	5.1	4.8
Other APIs	2.9	7.9	8.0	9.2	11.5	10.5	10.1	9.9	11.7	11.9
APIs	92.7	91.4	89.6	84.8	57.3	54.6	41.3	39.6	43.4	39.4
Synthesis and ingredients	7.3	8.6	10.0	12.9	13.6	10.8	18.6	37.5	24.7	29.3
Formulations	—	—	0.4	2.4	29.1	34.6	38.1	20.8	29.4	27.1
Laurus Bio (Richcore)	—	—	—	—	—	—	2.0	2.1	2.5	4.2
Total revenues	100	100	100	100	100	100	100	100	100	100
yoy growth (%)										
Anti-virals	32.6	0.9	4.0	(1.1)	(28.3)	70.5	(32.6)	27.6	8.8	(0.2)
Oncology	12.0	(24.1)	54.3	31.8	(3.5)	24.9	10.0	0.9	14.9	9.8
Other APIs	93.6	191.8	10.5	26.9	54.5	55.9	(1.0)	25.1	22.0	18.0
APIs	31.8	4.7	7.7	4.3	(16.5)	61.7	(22.2)	23.2	12.8	5.9
Synthesis and ingredients	77.6	25.1	27.2	42.4	30.6	34.8	76.6	159.6	(32.3)	38.3
Formulations	—	—	—	NM	1,411.5	101.6	13.0	(29.6)	45.1	7.2
Laurus Bio (Richcore)	—	—	—	—	—	—	—	31.9	22.0	100.0
Total revenues	34.3	6.2	9.8	10.3	23.5	69.7	2.7	28.6	2.8	16.6

Source: Company, Kotak Institutional Equities estimates

Exhibit 21: We forecast PAT CAGR of 9.2% for Laurus over FY2022-25E
Laurus' summary financials, March fiscal year-ends, 2016-25E (Rs mn, %)

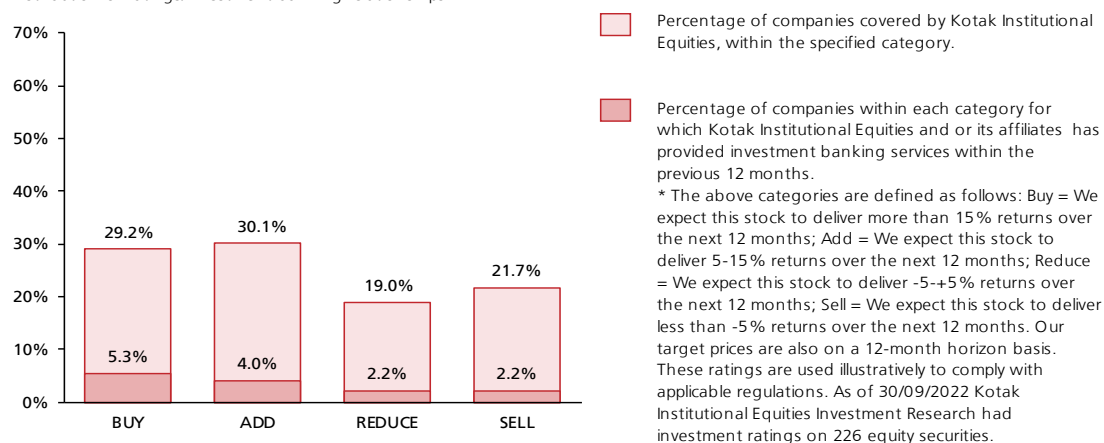
	2016	2017	2018	2019	2020	2021	2022	2023E	2024E	2025E
Net revenues	18,110	19,315	20,690	22,919	28,317	48,135	49,356	63,485	65,252	76,073
Gross profit	8,028	9,348	10,053	10,563	14,183	26,553	27,418	35,157	35,564	42,521
Adjusted EBITDA	3,622	4,076	4,133	3,560	5,645	15,507	14,224	16,986	15,925	20,563
Depreciation & amortisation	(864)	(1,060)	(1,255)	(1,642)	(1,873)	(2,051)	(2,515)	(3,399)	(4,152)	(4,992)
EBIT	2,758	3,017	2,879	1,918	3,773	13,456	11,709	13,588	11,773	15,571
Net interest	(1,067)	(665)	(505)	(720)	(837)	(445)	(871)	(1,199)	(1,083)	(1,080)
Profit before tax	1,690	2,352	2,374	1,198	2,936	13,011	10,839	12,389	10,689	14,491
Tax & deferred Tax	(349)	(439)	(698)	(260)	(383)	(3,173)	(2,514)	(3,283)	(2,694)	(3,652)
Minority interest	(4)	(11)	—	—	—	(2)	(49)	(50)	(50)	(50)
Net income (reported)	1,337	1,903	1,676	938	2,553	9,836	8,275	9,056	7,946	10,789
EPS (FD) (reported) (Rs)	2.7	3.6	3.2	1.8	4.8	18.4	15.4	16.9	14.8	20.1
Balance sheet										
Cash & equivalents	288	105	31	30	17	485	754	446	516	163
Debtors	4,449	5,676	5,706	7,099	7,914	13,061	13,542	17,418	17,903	20,872
Other current assets	5,291	5,617	6,739	7,500	10,189	17,203	19,151	22,502	23,509	26,367
Current assets	10,027	11,398	12,476	14,630	18,121	30,749	33,446	40,367	41,928	47,403
Fixed assets (incl. goodwill)	10,906	13,732	16,440	17,387	17,506	24,776	33,276	39,878	47,726	54,734
Other non-current assets	1,302	1,404	1,252	1,295	1,876	1,982	2,958	2,958	2,958	2,958
Total assets	22,235	26,534	30,167	33,312	37,503	57,507	69,680	83,203	92,612	105,095
Short-term loans	4,814	6,442	8,382	8,481	8,918	8,861	11,357	11,357	13,000	13,000
Creditors and other liabilities	4,023	4,820	4,687	5,758	8,006	15,710	15,453	19,883	19,703	21,397
Current liabilities	8,837	11,262	13,069	14,239	16,924	24,572	26,810	31,240	32,703	34,397
Long-term loans	4,597	1,246	1,417	2,587	1,650	5,671	5,963	6,000	6,000	6,000
Other liabilities (incl. deferred)	232	722	855	906	1,232	1,257	3,316	3,316	3,316	3,316
Total liabilities	13,667	13,230	15,341	17,732	19,805	31,500	36,090	40,556	42,020	43,714
Equity (inc. minority interest)	8,568	13,304	14,826	15,580	17,698	26,007	33,591	42,646	50,592	61,381
Total equity and liabilities	22,235	26,534	30,167	33,312	37,503	57,507	69,680	83,203	92,612	105,095
Cash flow										
CF from operations pre WC	3,409	3,844	3,920	3,497	5,472	13,271	12,527	13,753	13,356	17,111
Working capital	(1,476)	(525)	(495)	(520)	(1,998)	(5,941)	(3,416)	(2,798)	(1,671)	(4,134)
Capex	(3,370)	(2,775)	(3,911)	(2,543)	(2,222)	(6,888)	(8,768)	(10,000)	(12,000)	(12,000)
FCF	(1,437)	545	(486)	434	1,252	442	343	955	(315)	977
Ratios										
Gross margin (%)	44.3	48.4	48.6	46.1	50.1	55.2	55.6	55.4	54.5	55.9
EBITDA margin (%)	20.0	21.1	20.0	15.5	19.9	32.2	28.8	26.8	24.4	27.0
RoE (%)	15.6	14.3	11.3	6.0	14.4	37.8	24.6	21.2	15.7	17.6
RoCE (%)	15.6	14.4	11.7	7.2	13.4	33.6	23.3	22.8	17.0	19.4
Net debt to equity (X)	1.1	0.6	0.7	0.7	0.6	0.5	0.5	0.4	0.4	0.3

Source: Company, Kotak Institutional Equities estimates

"Each of the analysts named below hereby certifies that, with respect to each subject company and its securities for which the analyst is responsible in this report, (1) all of the views expressed in this report accurately reflect his or her personal views about the subject companies and securities, and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report: Alankar Garude, Samitinjoy Basak."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of September 30, 2022

Ratings and other definitions/identifiers

Definitions of ratings

BUY. We expect this stock to deliver more than 15% returns over the next 12 months.

ADD. We expect this stock to deliver 5-15% returns over the next 12 months.

REDUCE. We expect this stock to deliver -5-+5% returns over the next 12 months.

SELL. We expect this stock to deliver <-5% returns over the next 12 months.

Our Fair Value estimates are also on a 12-month horizon basis.

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