JOINDRE CAPITAL SERVICES LTD.

SEBI REGN NO. INH000002061 / INB 230766739 / INB 011107555

RESEARCH REPORT

14th Dec 2017

LASA SUPERGENERICS LIMITED

BSE : LASA | **Sector: VETINARY API & ANIMAL HEALTHCARE** | **BSE: 540702**

View - BUY

CMP : Rs. 131

Target Price: Rs 225(In next 12 to 18 mths)

BUSINESS BACKGROUND

Lasa Supergenerics Limited ('Lasa') is a vertically integrated player spanning the entire veterinary, animal and human healthcare value chain—from discovery-to-delivery, with established credentials in research, manufacturing and global marketing.Lasa is a veterinary API manufacturing entity, which was acquired in April 2012. for around Rs 6 crs. OSCL acquired Lasa as a part of forward integration for some of its chemicals. From a revenue base of less than 10 crs before acquisition, Lasa has reached revenue of Rs 200 crs now The manufacturing base of Lasa is located at Mahad, in the Konkan region of Maharashtra. It specialises in 'catalyst chemistry' and manufactures anthelmintic/ veterinary API products with the largest production capabilities and product categories in India.

INVESTMENT HIGHLIGHTS

Strong Financials for Lasa as on H1 FY18 –

Lasa reported a strong set of H1FY18 numbers with net sales at Rs 125.54 crs, as with EBIDTA placed at Rs 28.35 crs and the PAT in H1 FY18 at Rs 15.68 crs

For FY17 the company has recorded net income of Rs 199.99 crs, a EBIDTA of Rs 43 crs and a Net Loss of Rs 0.63 crs. This net loss was after a exceptional write of Rs 30.60 crs. Without this PAT would have been significantly higher.

Lasa has a well diversified product basket in the Animal Health Segment –

Lasa's product basket includes Veterinary products APIs, Animal Feed Ingredients and Re Agents for Therapeutic uses.

Lasa's production facilities are WHO Good Manufacturing Practices (GMP) and FDA approved. Lasa has also filed 7 process patents with Patents Office, Govt of India. Lasa has also obtained Certificate of Suitability from European Directorate for the Quality of Medicines & Healthcare (EDQM), for selling one of its premium products, Fenbendazole.

Lasa has also applied for a few more regulatory approvals like FAMI-QS and TGA. Once these approvals come, target markets would expand for Lasa.

KEY DATA

FACE VALUE Rs	10.00
DIVD YIELD %	NA
52 WK HI/LOW	157/125
NSE CODE	LASA
BSE CODE	LASA
MARKET CAP	RS 301 CRS

SHAREHOLDING PATTERN

PROMOTERS	-	70%
BANKS, MFs & DIIs	-	%
FIIs	-	%
PUBLIC	-	30%

KEY FUNDAMENTALS

YE	FY18	FY19	FY20
Rev Gr%	28	23	25
EBIDTA Gr%	34	24	26
PAT Gr%		25	36
EPS Gr%		25	36
EPS (Rs)	11.24	14	19
ROE %	27	26	27
ROCE %	17	20	21
P/E(x)		10	7

Rationale for De Merger from Omkar Speciality Chemicals Ltd –

The key reason and rationale for the De Merger of Lasa in to a independent company was to enable it to focus on its core product competentcy namely Veterinary APIs which was different from speciality chemicals manufactured by OSCL.

Businesses of OSCL - divergent business profile, growth potential, risk-rewards, regulatory and capital requirements and are largely independent of each other

Demerger of the Veterinary API undertaking into Lasa Supergenerics Limited is primarily with intention of achieving operational efficiencies

As the deals of the proposed De merger the exising share holders of OSCL were offered a share exchange ratio - 1:1 i.e. for every one fully paid up Equity Share of Face value Rs. 10 each held with OSCL

Hence every shareholder was entitled to one Equity Share of face value Rs. 10 each of Lasa Supergenerics.

According to the Top Management, both the companies, Omkar Speciality and Lasa Supergenerics have different businesses and product lines.

This de-merger will enable each Company's Management to leverage upon their experience and expertise and take the businesses to greater heights. Post the De-merger, Mr Omkar Herlekar will be responsible for the operations at Lasa Supergenerics Ltd while Mr Pravin Herlekar will be in charge of OSCL – the parent company.

To increase management focus on the two separated businesses. – OSCL has gone to father, Pravin Herlekar; while Lasa is being managed by the son, Omkar Herlekar.

As per info, there were differences between the two. Now, with separate ships, both can focus on growing their business while staying clear of each other.

Before Spin-off, the merged entity was headed by Pravin Herlekar, who was the Chairman and Managing Director while Omkar Herlekar (son) was whole time Director. While Mr. Pravin Herlekar is B.Tech in Chemical Engg from IIT Bombay and MBA from Mumbai University and was the founder of Omkar Speciality; Mr. Omkar Herlekar has done B.Sc and MSc from UDCT, Mumbai (one of the best institutes for studying Chemical Technology in the country).

Over the course of last two-three years there have been various problems with the company, due to internal as well as external factors –

Working capital issues- OSCL had reached a working capital of 203 days as on FY14 as they were giving easy credit terms to clients, as a result of which additional working capital needs were not being met by the banks.

Environmental Clearance issue- OSCL was putting up a significant capacity at Chiplun plant for expansion. However, due to hurdles of environment clearance, they couldn't operate that unit for a long time despite putting in a large capex.

QIP failure- To meet the working capital needs, the management thought of doing a qualified institutional placement (QIP). But due to poor sentiments, small size and stretched balance sheet, they couldn't generate enough demand for the QIP.

Pledging- To meet company's and personal requirements (including, but not limited to, buying shares of own company), promoters had to take loans from a few NBFCs which charged a high rate of interest. To get this funding, they had to pledge their shares in the company.

Now with the OSCL-Lasa demerger, father-son duo has also separated. Father, Pravin Herlekar will be managing the parent, OSCL. And, Lasa will be managed by the son, Omkar Herlekar. Since the acquisition in 2012, Omkar Herlekar was largely taking care of Lasa's operations and hence, managing it in future should not be a problem for him.

LASA has a well established Infrastructure to take care of its clients needs in a optimum way –

Manufacturing facilities Post Demerger –

Lasa, Mahad - APIs (Veterinary)

Urdhwa, Chiplun - Organic Intermediates

Unit V, Chiplun – Organic intermediates

Unit VI, Chiplun - Organic Intermediates

Lasa has a large growing customer base for its veterinary APIs which includes some names like Novartis, Mylan, Merck, Cambrex, Sanoffi, Sanovel, DSM, Amul, Evonik, IPCA, Lupin, Divis, Glenmark etc.

Some Key Positives of Lasa as on date –

Good product list with approvals- Company's production facilities are WHO Good Manufacturing Practices (GMP) and FDA approved. Company has filed 7 process patents with Patents Office, Govt of India. Company has also obtained Certificate of Suitability from European Directorate for the Quality of Medicines & Healthcare (EDQM), for selling one of its premium products, Fenbendazole.

LASA has also applied for a few more regulatory approvals like FAMI-QS and TGA. Once these approvals come, target markets would expand for Lasa.

Good financials in an attractive industry– Lasa has grown at a good rate while maintaining its margins and return ratio and Animal health industry dynamics are attractive for a long term investor.

Headwinds of Omkar Speciality gone– With independent listing, company is now free from legacy issues of the parent, OSCL namely working capital problems and promoter selling.

Also, hitherto, Lasa was manufacturing only those APIs for which OSCL had in-house ability to manufacture the raw materials required by Lasa. Now they plan to enter into newer products which would increase opportunity size for Lasa.

Capacity enhancement promises future potential– Company has recently commissioned a new unit which till now was part of Capital WIP. Company is operating at 75% utilization rate and has confirmed orders in hand which gives good visibility of future growth.

Export Potential– Major Chunk of Lasa revenues are from the domestic markets. However exports accounted for 40% of rebeues. On the other hand, closest competitor, Ngl Finechem generates 70% of revenues from the export markets. Margins are higher in the export markets.

Pharma vs Animal health pharma

Despite being a sub-set of pharmaceuticals industry, animal health pharmaceuticals industry has quite different industry dynamics-

Favourable pricing environment–

Unlike the pricing landscape of human prescription medicines, where pricing pressure and price control have been the regulator's and government's major weapon to control burgeoning healthcare costs, the animal health market has seen little direct government involvement.

Unlike human pharmaceuticals industry where eventual buyers are insurance companies or government; in animal health industry, buyers are pet owners and animal farm owners. So, there is hardly any incentive for government to get involved to fix the prices.

Higher R&D productivity–

Unlike human health, the animal health industry is characterized by higher R&D productivity and shorter development time, as well as lower costs and risks. Animal health products generally show faster R&D timelines in all stages ranging from research to the regulatory review process.

Hence, in aggregate total development timelines are typically 3 to 5 years faster than in human drug development.

Limited competitive intensity–

Competition is lower in animal health industry. There is very limited overlap in product portfolio of 'Top-10' companies. Market is dominated by Big US pharma and a few European players.

However, regulatory scrutiny is increasing in Animal health industry. This is making companies to look out for compliant, reliable and high quality suppliers. And this provides an attractive opportunity for Indian players.

India Veterinary Healthcare Market

The veterinary healthcare market by diagnostics may be defined as the diagnostics tests that are carried out for the detection of various diseases in animals. These processes are executed through various methods that use blood, feces, and tissue sample from animals.

India's Veterinary Healthcare Market- Huge Market Opportunity Ahead

Veterinary healthcare is gaining importance as a result of manufacturers focusing on the production of products with specialized formulations and manufacturing processes. These are essentially beneficial for animal lovers and companion animal owners.

In India, Animal Husbandry is making a significant contribution to the national economy and socio-economic development of the country. With 10.71% of world's livestock population, India stands first in buffalo population, second in cattle and goat population, third in sheep, fifth in chicken and sixth in camel population world over with bovine population of 299.9 million, 135.17 million goats, 65.06 million sheep, 10.29 million pig, 0.4 million camels and 729.2 million poultry as per latest census.

India stands number one in world for total milk production with an estimated milk production of 140 million tonnes with an average yearly growth of over 4% and per capita milk availability of around 307 grams per day.

Poultry industry which provides cheap source of animal protein has taken a quantum leap in the last few decades evolving from a near backyard practice to a venture of industrial promotion. The egg production in 2012-13 was 69.73 billion with an annual growth rate of 4.94% with per capita availability of 61 eggs. Meat production including poultry was 6.3 million tonnes. India is the second largest producer of fish and the second largest producer of fresh water fish in the world contributing 5.86% of the global fish production. The total fish production was 9.45 million tonnes (3.44 million tonnes for marine and 6.10 million tonnes for inland fisheries).

The total contribution of livestock sector at current prices was about 4063.5 billions which was about 21.58% of the total agriculture and allied sector. The livestock sector is contributing about 3.88% of total gross value added to the country at current prices and about 3.92% at constant prices (2011-12). The livestock sector has expanded by 5.5% during 2013-14 against the total growth of 3.7% during the same period in agriculture.

The animal husbandry and dairy sector play a significant role in supplementing family incomes and generating employment in the rural sector. More than 20.5 million workers are engaged in animal farming and about 87.7% of the livestock is owned by farmers of marginal, small and semi-medium operational holdings.

Key Demand Drivers here –

- Increase in the ownership of pet animals
- Increased awareness about animal health
- Technological advancements in developing animal healthcare diagnostics
- Population boom
- Stable economy, which is expected to result in increase in the demand for protein-rich foods

Key Restraints here include –

- Increasing spread of various infections in humans from animals through consumption of animal products
- Rise in competition for cultivated land
- Scarcity of arable land

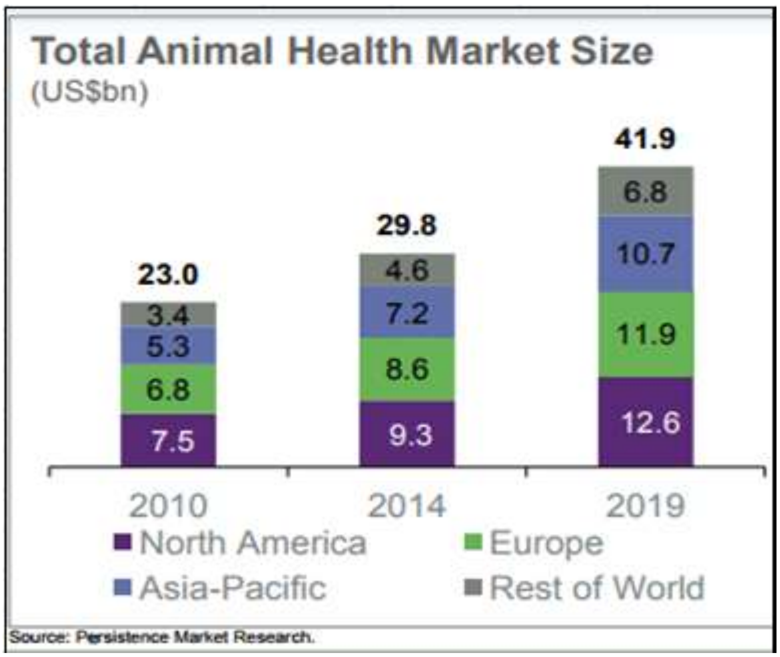
Opportunities and Challenges going ahead –

The increase in exports of animal products from India to other countries and the fewer requirements of animal drug approval in the subcontinent are the major opportunities for the market to grow. However, declining veterinarian population and the lack of awareness about animal healthcare in rural areas of the country are some of the major challenges for the key players.

The Indian veterinary market can be broadly segmented based on animal types and diagnostics. Based on the animal type, the market is further segmented into farm animal health market (poultry, swine, fish, cattle, and sheep) and companion animal health (dogs, cats, horse). Based on diagnostic tools, the market is further sub-segmented into clinical chemistry, hematology tests, molecular diagnostics, diagnostic imaging and other veterinary diagnostic products.

Some of the key players in the market are –

- Bayer Animal Health
- Elanco Animal Health
- Merck Ltd.
- Merial (Animal Health division of Sanofi)
- Zoetis Animal Healthcare
- With the adoption of international lifestyle and changing food habits, there is an increasing trend of meat consumption. There has been a considerable growth in zoonotic diseases (disease transmitted from Animals to Humans), due to the upsurge in the animal population.
- There is a rising trend for pet adoption, cats and dogs. With the Global Veterinary API market having a market size of $670 mn globally (INR 4,500 cr).
- Indian domestic Veterinary API market is 650 cr and is growing at a fast rate due to outsourcing opportunities.



Globally alsio the animal health industry is on a growth trajectory, powered by the popularity of pet ownership and a global population hungry for meat and dairy products.

The many large and small companies that develop and manufacture drugs and vaccines for pets and livestock animals are expected to generate $33 billion in sales by 2020, after a record $24 billion in 2014, according to the consulting firm Vetnosis. Wall Street and the European and Asian markets are paying attention

The animal health industry has profited from the rise in pet ownership and increased spending on healthcare for pets. An estimated 65 percent of U.S. households have pets, and that percentage is expected to increase, said Kausche. According to a 2015 Harris Poll, 95 percent of U.S. dog and cat owners consider their pets as members of the family. “Companion animals over the years have moved from the barn to the garage to the living room to the bedroom to the bed,” Because pet dogs and cats are now living longer, they are at increased risk for developing cancer and other age-related disorders such as osteoarthritis, cardiovascular disease, diabetes, and renal disease. Thus, age-related disorders provide niche markets for the animal health industry.

The rise in pet ownership and the projected increase in the growing global population's demand for meat and dairy products are not the only reasons that investors are paying more attention to the animal health industry. The R&D cost for a new animal health drug is about $50 million to $100 million compared to more than $1 billion for a human drug

However, unlike the human biopharmaceutical industry, the animal health sector rarely has produced a blockbuster product. Merial's Frontline flea and tick control product is the only pet medication that has generated annual sales of more than $1 billion, making it the first blockbuster drug for pets.

Unlike human biopharmaceutical companies, the major animal health companies develop drugs and vaccines not just for one species, but for multiple species — chickens, cattle, pigs, and sheep, as well as horses, cats, and dogs. Because these different species do not share the same physiology and disease susceptibilities, animal health R&D is more complex than biopharmaceutical R&D

Globally according to Merial, (Animal Health division of Sanofi) to feed the world in 2030, animal protein production will have to increase by 30 percent from its current level,and without effective disease prevention and health management strategies, this could impact the meat and dairy industries in a big way.

The top five animal health industry market leaders and their reported FY2015 revenues are: Zoetis, $4.8 billion; Merck Animal Health, $3.3 billion; Elanco, a division of Eli Lilly, $3.1 billion; Merial, €2.5 billion ($2.8 billion); and Bayer Animal Health, €1,490 million ($1.7 million).

CONSOLIDATION DEALS IN AH, 2011-2015

DATE CLOSED	TARGET	ACQUIRER	DEAL VALUE ($M)
01/2015	Eli Lilly/Elanco: Sentinel	Virbac SA	
01/2015	Novartis: AH division	Elanco (Eli Lilly)	5,400
01/2015	Novartis (India): AH division	Elanco (Eli Lilly)	14
04/2014	Bioniche Animal Health	Vetoquinol	55
12/2013	Glon Sanders: Lab. Sogeval	CEVA Sante	
06/2013	Dosch: AH division	Merial (Sanofi)	
09/2012	Orsco SAS	Vetoquinol	21
05/2012	Eurovet Animal Health	Dechra Pharma	176
10/2011	CentaurVA Animal Health	CEVA Sante	
07/2011	J&J Janssen: AH business	Elanco (Eli Lilly)	
02/2011	Alpharma*	Pfizer (Zoetis)	345*

*Represents value of Alpharma deal, which was part of the acquisition of King Pharma (total deal value: $3.5B). Note: In addition to the above deals, several major transactions influenced the AH competitive landscape, including Merck & Co.'s merger with Schering-Plough (which included AH business Intervet) and subsequent divestiture of its 50 percent stake in Merial to Sanofi; plus, Pfizer's acquisition of Wyeth (which included AH business Fort Dodge).

Source: Thomas Reuters, company reports and news, PwC analysis

Antiparasitic animal health API has the highest market share and growth rate in the overall global market

Antiparasitic API growth in the global animal health API market is owing to a large number of pharmaceutical industries in the Asia Pacific region especially focusing on antiparasitic APIs. This segment is anticipated to dominate the global animal health active pharmaceutical ingredient market in revenue terms in 2017, and the trend is projected to continue throughout the forecast period.

Antiparasitic API is expected to be the most lucrative segment, which is expected to grow from more than US$ 2,500 Mn in 2017 to over US$ 4,600 Mn by 2025 end. Anti-infectives is also expected to be the second largest market for animal health active pharmaceutical ingredients.

Going Ahead Animal health API outsourcing could be a big opportunity for Indian Players here –

Shifting the pharmaceutical manufacturing base to developing countries provides a huge opportunity for earning profits because of the lower cost of manufacturing, increasing FDI & government support.

Asia Pacific region has a huge opportunity for facility upgradations and less regulatory permissions provide potential for investment.

Asia Pacific (APAC) will continue to be the most lucrative region in the global animal health active pharmaceutical ingredient market, with sales exhibiting the second highest CAGR through 2025.

APAC has remained one of the largest API suppliers, at affordable costs. Governments across APAC have been making investments and focusing on local manufacturing facilities of APIs. Favorable policies offered by these governments have been shifting the focus of API manufacturers in moving their production bases to APAC countries, such as India and China. In addition, limited insurance or government intervention provides smooth flow to market growth in these regions.

Lasa enjoys a reasonably good balance sheet and both Topline and Bottomline growth is likely to remain strong going ahead –

Post De merger Lasa had a debt of around Rs 107 crs and a Fixed Asset Base of Rs 140 crs.

In terms of financial performance for FY17, Lasa posted a Topline of close to Rs 200 crs, a EBIDTA margins of 21.5% and a PBT of Rs 27.60 crs but there was a one time exceptional loss of Rs 30.61 crs which was on account of the transfer of assets at the time of demerger. Hence netloss totaled Rs 63 lacs in FY17.

However Lasa has shown consistent growth since last 5 years starting from FY13 onwards when its Topline was Rs 108 crs which has now touched Rs 200 crs as on FY17 while PBT has improved from 1.25 crs from Rs 27.56 crs in the same period with net margins progressively up to around 10%. In H1 of FY18 Lasa has already recorded a Topline of Rs 125.54 crs, a EBIDTA of Rs 28.35 crs and a PAT of Rs 15.68 crs on a equity base of Rs 22.86 crs.

We expect that going ahead overall bottomline growth in the next 3 years starting FY17 onwards should easily increase at a CAGR of 23-25% and going ahead also we believe that net cash flows generated will remain healthy going ahead.

Business Outlook & Stock Valuation –

On a rough cut basis, in FY18, Revenue is expected to touch Rs 255 crs.

On the bottomline level we expect the company to record a PAT of Rs 25.70 crs in FY18E. Thus on a conservative basis, Lasa should record a EPS of Rs 11.24 for FY18E. For FY19E and FY20E our expectation is that earnings traction for Lasa will continue to remain strong wherein we expect a EPS of Rs 14 and Rs 19 respectively.

Lasa is a market leader in the Vetinary API market which is a high entry barrier business where it is a niche player accounting for 35% share in the domestic Animal Healthcare market. It also has fully backward integrated fungible manufacturing capacities and has around 13 key products which enjoy high demand levels from the Animal Health market. Its facilities are also certified and approved in 4 FDI approved Pharma zones globally and currently has 10 DMF approved products of which 7 are in the pipeline.

We expect that going ahead overall bottomline growth in the next 3 years starting FY17 onwards should easily increase at a CAGR of 23-25% with the ROE and ROCE is also expected to improve to 26% and 27% and 20% and 21% by FY19 and FY20.

Going ahead we expect Lasa's earnings to grow at a 23-25% over FY17-20E led by a rising healthy Topline growth, prudent product strategy and sustainability of good profit margins.

The Lasa stock trades at a P/E of 10x and 7x based on FY19E and FY20E, which looks attractive considering its strong execution capability, consistent financial track record and looking at future potential for the domestic prospect s for Animal Husbandry and also looking at the Global opportunity from MNCs here.

Also valuations at 1x Market Cap tio Revenue based on FY19E don't look very expensive and hence we believe that the Lasa stock should be purchased at the current price for a price target of around Rs 225 over the next 12 to 18 months.

FINANCIALS

For the Year Ended March RsCrs	FY17A	FY18E	FY19E	FY20E
Net Sales	199.99	255.3	314.02	392.52
EBIDTA	43.00	57.69	72.50	92.28
EBIDTA %	21.50	22.60	23.09	23.51
Interest	14.44	10.00	11.55	12.80
Depreciation	13.00	20.00	23.00	23.00
Non Operational Other Income	1.50	3.00	3.00	3.00
Profit Before Tax	27.6	30.69	40.95	57.48
Profit After Tax $	-0.63	25.7	32.05	43.8
Diluted EPS (Rs)		11.24	14.02	19.16
Equity Capital	22.86	22.86	22.86	22.86
Reserves	58.9	84.6	116.65	160.45
Borrowings	107.00	68.00	75.00	85.00
GrossBlock	140.00	162.00	182.00	207.00
Investments	0.00	0.00	0.00	0.00

Source Company our Estimates $ After exceptional one time loss of Rs 30.61 crs before de merger.

KEY CONCERNS

Slowdown in the Domestic Animal Healthcare Market will have a direct negative impact on Lasa's business

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