



BP WEALTH

Neuland Laboratories Ltd.

Initiating Coverage Report



Niche API play, with turnaround potential

Jan 2020



Table of Content

Summary on Business Profile & Explanation on why we like this company.....	2&4
Investment Rationale.....	5-11
Tilting business mix towards high margin APIs	5-7
⇒ Prime APIs : Slow and Steady path ahead	
⇒ Specialty APIs : Strong traction	
CMS business to ramp up, with greater profitability.....	8-10
⇒ Bilaxten : One of the key products in CMS	
Financial performance to improve further	11
Company Background	12
Key Milestone & Management Team	13
Peer Comparison, PE Band and Key Risks	14
Valuation & Outlook	15
Financial Statements.....	16-19
Disclaimer.....	20

Company Background

Incorporated in 1984, Neuland Laboratories Ltd (NLL) is primarily into manufacturing of active pharmaceutical ingredients for global pharmaceutical companies. It also provides end-to-end solutions for the pharmaceutical industry for chemistry-related services from synthesis of library compounds to supply of New Chemical Entities (NCEs) and intermediates at various clinical phases up to commercial scale.

NLL has three manufacturing facilities in and around Hyderabad, Telangana with total installed capacity of 729.70 Kilo Litre as on March 19. The company also provides Custom Manufacturing Solutions (CMS) to develop and manufacture pharmaceutical ingredients and intermediates in line with customer expectations. The company has portfolio of around 50 products with presence in 25 therapeutic segments including Antibacterial, Antidepressant, Bronchodilator, Anticonvulsant, Antipsychotics, Antiparkinsonian, Antihypertensive and Anatomical.

Investment Rationale

Tilting business mix towards high margin APIs

Based on the product lifecycle, NLL has split the GDS (Generic Drug Substances) operations into prime APIs (high volume, mature products) and specialty APIs (low volume, high-value products). Prime APIs brings 55% to its overall revenue; the rest is derived from the specialty APIs. Going forward, the company's strategy is to tilt the business mix from 'low-value, high-volume' to 'high-value' products with an aim to add 4-5 products in next two years. We expect GDS to register 8.3% revenue CAGR over FY19-22E, driven by new product launches and market share gain in existing products. The Prime API is expected to grow at slower pace (~5% CAGR) as the focus is largely on high-value, low-volume products. Further, the company expects the number of products having revenue of INR200mn+ to increase from 7-8 in FY19 to 10-12 in next two to three years. This clearly indicates the vast potential of products in the pipeline, which would then accelerate the revenue growth momentum.

CMS business to ramp up, with greater profitability

The revenue from Custom Manufacturing Solutions (CMS) (margin-accretive) business clocked a CAGR of 12% over FY14-19 and contributed 14% of revenue in FY19. The CMS business involves manufacturing API to customer specifications, designing and developing manufacturing processes, process optimization for competitiveness and filing of DMF/CMC for API among others. These are novel molecules (covered under patent protection) for which NLL is the only or one of the two approved suppliers, which shows the limited competition in the segment. This provides stable revenue for the business. API/intermediate volumes increase as the approved formulation gains acceptance across the globe. NLL has non-exclusive agreements to manufacture products with leading generic and innovator companies across Europe, the US and Japan. During FY19, the revenue from CMS segment declined by 12.6% (vs FY18), due to a shift in scheduled deliveries from Q4FY19 to FY20 and lower offtake of a commercialized product during FY19. However, the number of projects has increased year-on-year from 40 as on March 18 to 56 as on March 19. The Company added 12 products (7 APIs and 5 intermediates) to its basket during H1FY20. We expect the contribution from the high-volume segment to be gradually replaced with the CMS segment and to register healthy revenue growth of 40.8% over FY19-22, fueled by the ramp up in supplies of existing products and possible commercialization of products in clinical trials

Stock Rating

BUY	HOLD	SELL
> 15%	-5% to 15%	< -5%

Sector Outlook

Neutral

Stock

CMP (Rs)	422
Target Price (Rs)	663
BSE code	524558
NSE Symbol	NEULANLAB
Bloomberg	NLL IN
Reuters	NEUL.BO

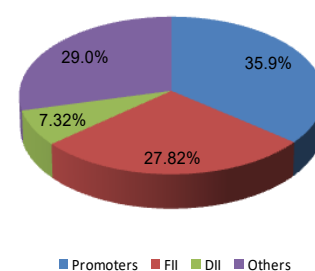
Key Data

Nifty	12,025
52 Week H/L (Rs)	824/380
O/s Shares (Mn)	12.8
Market Cap (Bn)	5
Face Value (Rs)	10

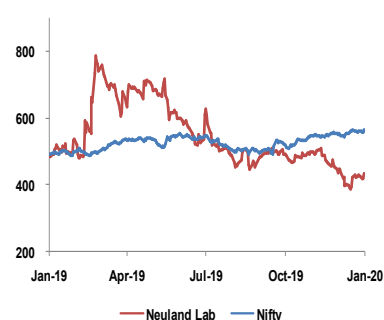
Average volume

3 months	23,590
6 months	23,080
1 year	30,880

Share Holding Pattern (%)



Relative Price Chart



Research Analyst

Nikhil Shetty

nikhilshetty@bpwealth.com

022-61596408

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Financial Performance to improve further

We expect NLL to register a 13.8% CAGR in revenue, to INR9.8bn, over FY19-22E. The growth is likely to be driven by a margin-accretive portfolio, namely high-value APIs (through the launch of products, which would turn out to be vast revenue opportunities). Its CMS business would, similarly, register strong revenue growth, driven by an increase in commercial supplies. We expect the EBITDA margin to improve 744bps over FY19-22E and come in strong at 16.2% with EBITDA in absolute terms to register a 39.7% CAGR over FY19-22E, powered by strong revenue growth in both its Specialty APIs and CMS businesses. We expect a 74.2% CAGR in adjusted net profit over FY19-22E, to INR869mn, boosted by healthy revenue growth and a strong EBITDA margin. The growth in net profit, would be considerably more than that in revenue, largely because of a non-major increase in the depreciation charge. FY18-19 caused NLL's return ratios to dip sharply (from RoE/RoCE of ~13%/17% in FY17 to 2.6%/3.6% in FY19) largely due to negative operating leverage (raw material price increase). Also, a heavier balance sheet due to the acquisition of the new Unit 3 caused a further dilution. We expect gradual recovery in return ratios with a substantially higher top-line and profitability and better utilization of the new facility (currently supplying intermediates for internal consumption) post USDFA inspection. The net-debt to equity is now ~0.3x and is likely to further slip to 0.2x by FY22E led by improved FCF generation and WC management. We expect the interest-coverage ratio to improve to 10.2x in FY22E, from 3.7x in FY19.

Why we like this stock & valuation methodology

While generic API manufacturing remains the pillar of NLL's overall business, the ramp-up in the CMS segment (API CRAMS); especially given the fertile product opportunities (like Bilastine and Peptide product) is expected to drive next phase of growth going forward. We believe NLL will continue to strengthen its balance sheet with strong operating cash flow generation of INR2.45bn over FY19-22E. Considering the expected strong growth in profitability, healthy balance sheet with improving return ratios, we are optimistic about the long-term growth prospects of the company. With a washout in FY18 and growth resumption in FY19, we believe that the CMP (down 45% from 52 week high) offers an attractive opportunity for investors to time an entry. We foresee 13.8% revenue CAGR, 744bps margin expansion and 73.2% growth in earnings over FY19-22E. The balance of portfolio among high value and high volume products will help it clock a faster growth in earnings. The stock trades at 6.8x FY22e EPS (ten-year average being 20.7x). We believe the stock will see a gradual re-rating on the back of stronger products pipeline and improved return ratios. We assign a valuation multiple of 10x (50% disc to 10 year avg P/E) FY22e EPS. We initiate coverage on the stock & recommend 'BUY' rating with a target price of INR 663 per share.



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Key Financials

YE March (Rs. mn)	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
Revenue	5,100	5,789	5,274	6,668	7,742	8,687	9,821
<i>Revenue Growth (Y-o-Y)</i>	8.7%	13.5%	(8.9%)	26.4%	16.1%	12.2%	13.1%
EBITDA	804	1,063	504	584	1,000	1,261	1,590
<i>EBITDA Growth (Y-o-Y)</i>	20.8%	32.2%	(52.6%)	15.7%	71.4%	26.1%	26.1%
Net Profit	273	469	121	164	469	622	855
<i>Net Profit Growth (Y-o-Y)</i>	71.3%	71.5%	(74.3%)	36.3%	185.1%	32.6%	37.5%
Diluted EPS	21.2	36.3	9.4	12.7	36.3	48.2	66.3
<i>Diluted EPS Growth (Y-o-Y)</i>	71.3%	71.5%	-74.3%	36.3%	185.1%	32.6%	37.5%
No of Diluted shares (mn)	13	13	13	13	13	13	13

Key Ratios

EBITDA (%)	15.8%	18.4%	9.6%	8.8%	12.9%	14.5%	16.2%
NPM (%)	5.4%	8.1%	2.3%	2.5%	6.1%	7.2%	8.7%
RoE (%)	15.4%	12.8%	2.2%	2.6%	6.5%	8.1%	10.2%
RoCE (%)	16.6%	17.1%	8.8%	3.6%	5.5%	8.4%	10.4%
Tax Rate %	35.5%	30.2%	13.4%	19.2%	20.0%	20.0%	20.0%
Book Value Per share (Rs.)	145	423	433	542	575	619	679

Valuation Ratios

P/E (x)	19.9x	11.6x	45.1x	33.1x	11.6x	8.8x	6.4x
EV/EBITDA	8.7x	6.7x	16.5x	12.3x	7.3x	5.9x	4.7x
P/BV (x)	2.9x	1.0x	1.0x	0.8x	0.7x	0.7x	0.6x
Market Cap. / Sales (x)	1.1x	0.9x	1.0x	0.8x	0.7x	0.6x	0.6x

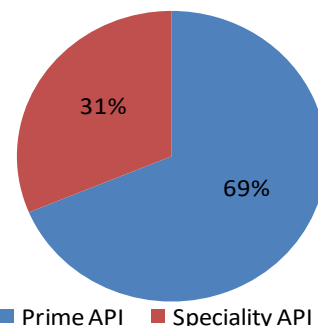
Source: Ace Equity, , BP Equities Research

Investment Rationale

Tilting business mix towards high margin APIs

NLL is a pure-play API manufacturer for several domestic and international pharmaceutical companies. The Company has three USFDA approved facilities (including acquired Unit 3 in 2017) that manufacture more than 75 APIs with 846 DMFs globally, addressing 36 therapies. NLL's APIs are primarily marketed in highly regulated markets such as the US, Europe and Japan (accounting for more than 82% of its sales) – which lends a watermark of credibility on the accuracy and reliability of its systems and processes. Based on the product lifecycle, NLL has split the operations into prime APIs (high volume, mature products) and specialty APIs (low volume, high-value products with elements of differentiation). As these spaces require a different mindset and expertise, the segregation facilitates in providing adequate focus on growing each segment individually.

GDS revenue breakup (in %)

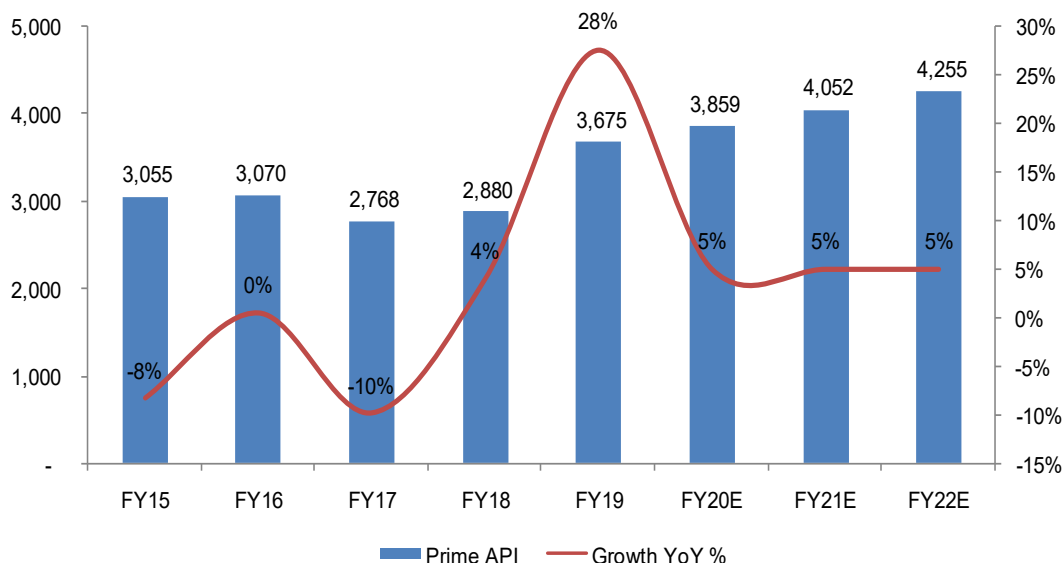


Source: Company, BP Equities Research

⇒ Prime APIs : Slow and Steady path ahead

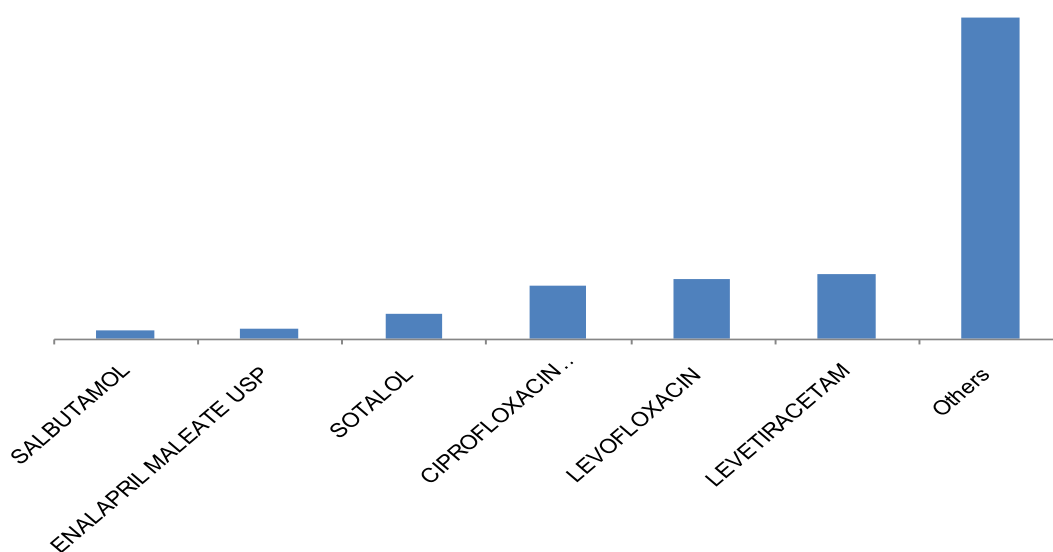
These typically include mature APIs that have relatively higher competition. These segments represent the high-volume part of the business and have the highest contribution to the company revenues. This segment comprises of over 15 APIs, of which Ciprofloxacin (anti-bacterial agent) and Levetiracetam (anti-epileptic agent) are the key molecules, which together contribute about 22% of the segmental top-line. Besides these two, other important molecules include Levofloxacin, Mirtazapine Enalapril Maleate, Sotalol, Labetalol and Salbutamol. Prime segment grew by 27.6% in FY19 on YoY basis; As per management, this growth was achieved on the basis of a conscious decision taken by the management to pursue market share for select products, which is expected to provide better returns over the long term. However, during same period the profitability from this segment got affected due to the escalation of raw materials costs, but the management believes that over a period of time normalcy will be restored in terms of margins even as they are working to bring down process costs.

Prime APIs to Grow 5% CAGR over FY19-22E



Source: Company BP Equities Research

Top 3 and Top 5 products contributes ~26% and 38% respectively



Other than Sotalol, Labetalol, Levetiracetam, Ezetimibe and Escitalopram, revenues are likely to remain subdued for the other molecules in next couple of years. Therefore, we expect Prime API segment to grow at 5% CAGR over FY19-22E

Source: Source: BP Equities Research

Apart from Sotalol, Labetalol, Levetiracetam, Ezetimibe and Escitalopram, revenues are likely to remain subdued for the other molecules in next couple of years. Therefore, we believe that this segment is expected to grow only at 5% CAGR over FY19-22E. Pricing pressure on customers and volume offtake are likely to neutralize, leading to muted growth. However, with the new intermediate capacity, NLL will likely improve the margin for prime segment going ahead. At present, we believe that the contribution of the prime segment to the top-line would be ~55% which would significantly go down in FY22E to ~43% .

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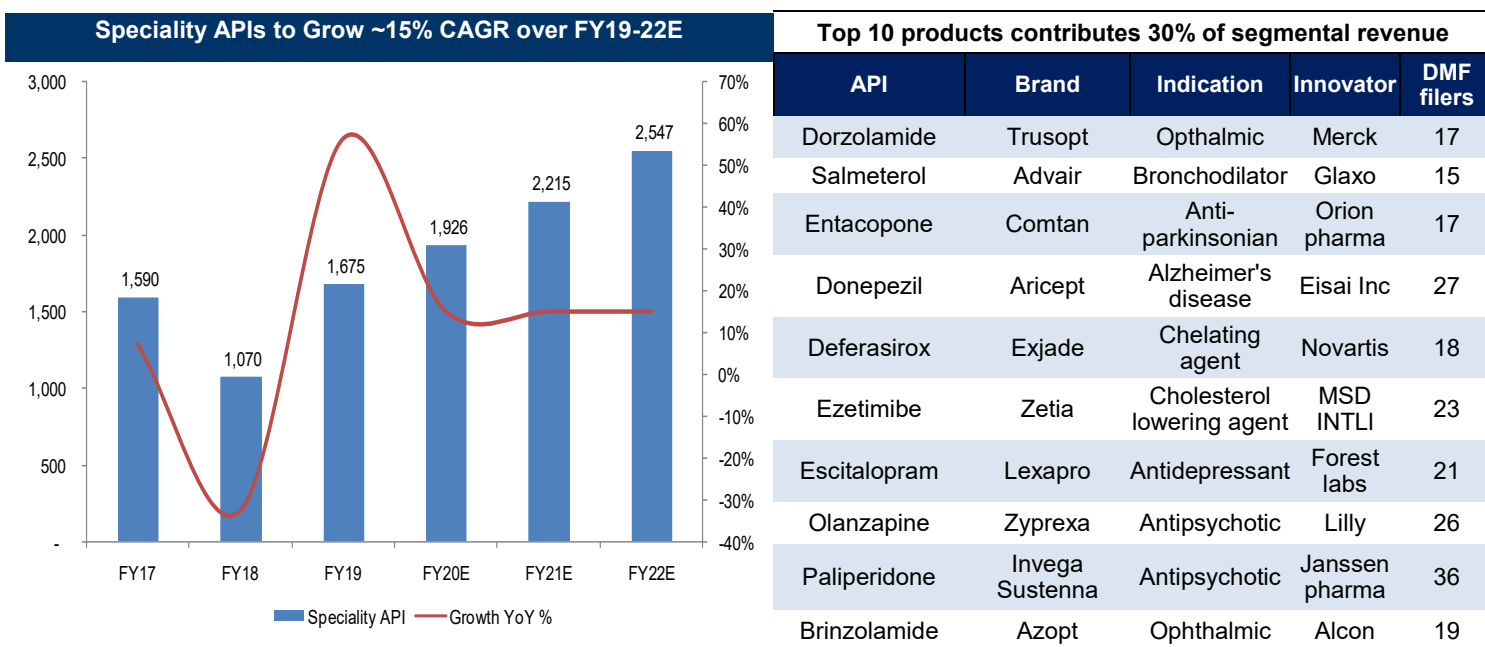
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⇒ Specialty APIs : Strong traction

In recent times, the company has shifted its focus more towards molecules which are technically complex in nature; generally low volumes but have significant value. Thus far, traction has been strong, with segmental top-line growing ~15% CAGR over FY14-19 which now contributes 25% to total revenue. The Company currently has 25 molecules in this segment. Of these, patents for some molecules are yet to expire. Important molecules from a revenue perspective are Salmeterol, Dorzolamide, Paliperidone, Deferasirox, Donepezil and Brinzolamide. In this segment, the Company generally is one of only two suppliers and in some case only supplier, for customers. Going forward, we see significant volumes coming from North American markets for Salmeterol, although management has not provided any specific timeline for the uptick in volumes.

Salmeterol is likely to be a significant growth driver for NLL going forward, both on the top and bottom-lines

In the specialty segment, there are several other API opportunities, which we believe can be optimized



Source: Company, BP Equity Research

in the future period. As we can see with many of these products, the company is selling APIs to either European and/or RoW markets and is yet to see the impact of generic player entries in the US market. We anticipate, revenue growth to speed up post generic API supplies to the US market. Going forward, We expect Salmeterol API supplies to ramp up once NLL's clients gets approvals in US. With higher sales from Brinzolamide, Dorzolamide, Donepezil and other products, the niche segment revenues are likely to grow 15% CAGR over FY19-22E. This will increase the revenue contribution from ~25% now to ~26% in FY22E with improved profitability.

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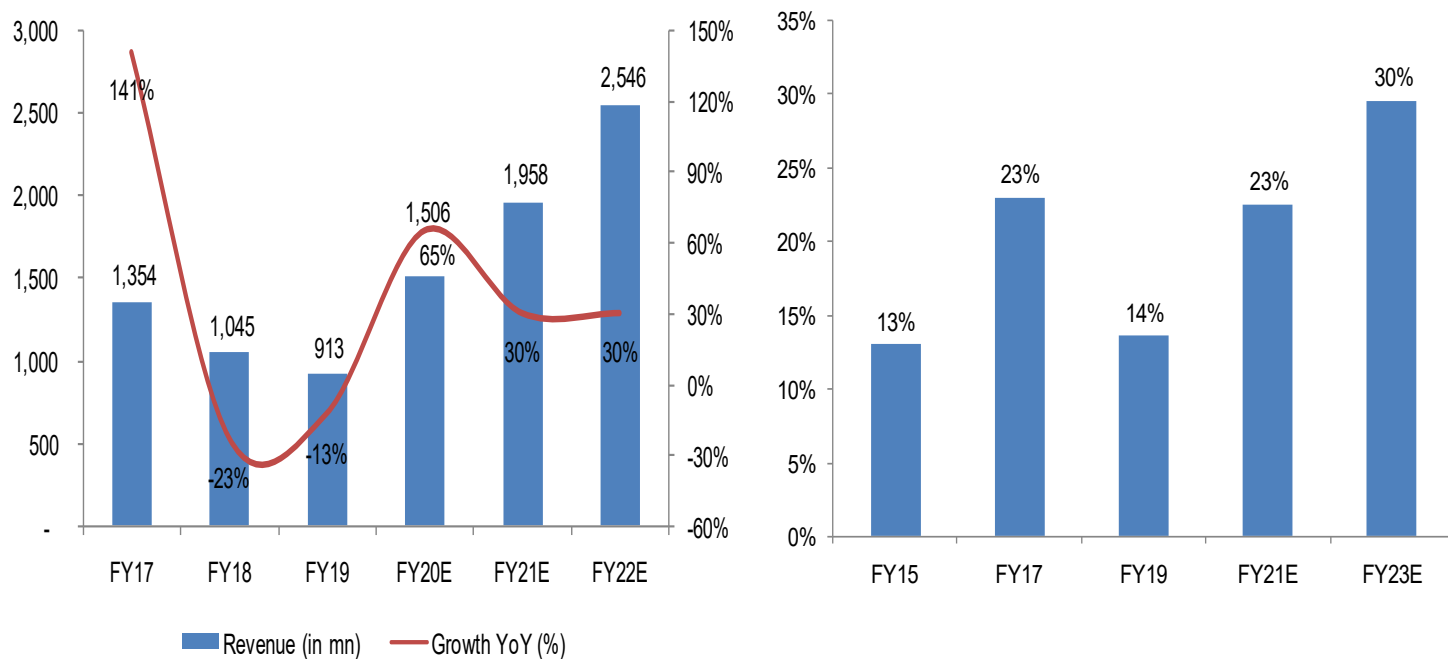
CMS business to ramp up, with greater profitability

The revenue from Custom Manufacturing Solutions (CMS) (margin-accretive) business clocked a CAGR of 12% over FY14-19 and contributed 14% of revenue in FY19. The CMS business involves manufacturing API to customer specifications, designing and developing manufacturing processes, process optimization for competitiveness and filing of DMF/CMC for the API among others. These are novel molecules (covered under patent protection) for which Neuland is the only or one of two approved suppliers – hence competition is limited. This provides stable revenue for the business. API/intermediate volumes increase as the approved formulation gains acceptance across the globe. Neuland has non-exclusive agreements to manufacture products with leading generic and innovator companies across Europe, the US and Japan. During FY19, the revenue from CMS segment has declined by 12.6% (vs FY18), which was on account of a shift in scheduled deliveries from Q4FY19 to FY20 and lower offtake of a commercialized product during FY19. However, the number of projects has increased year-on-year from 40 as on March 18 to 56 as on March 19. The Company added 12 products (7 APIs and 5 intermediates) to its basket during H1FY20. We expect the contribution from the high-volume segment to be gradually replaced with the CMS segment and to register healthy revenue growth of 40.8% over FY19-22, fueled by the ramp up in supplies of existing products and possible commercialization of products in clinical trials

There are 4-5 molecules in the CMS pipeline that could be commercialise over 2-3 years with revenue potential of INR500-600mn/each.

Possible commercialization of molecules to accelerate revenue

CMS revenue share to reach 30% by FY23



Source: Company BP Equities Research

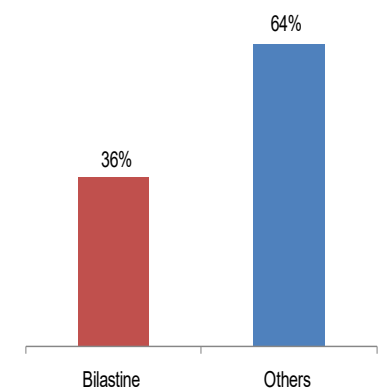
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⇒ Bilaxten : One of the key products in CMS

Currently Bilastine constitute 36% of the total CMS revenues

Bilastine, sold under the brand name Bilaxten, is an anti-histamine medication which is used in the treatment of allergic rhinoconjunctivitis and urticaria (hives). It is marketed by Faes Farma, a Spanish pharmaceuticals company. NLL is one of the only 2 suppliers for this molecule; with the company believed to have around 50% of the supply share. NLL is also in discussion to supply some key intermediates to the other API supplier, which could be a significant boost to the business from Faes Farma. We believe launching in new markets every year by Faes Farma could accelerate revenue potential of Bilastine API for NLL. We believe this product has potential to become Rs 600-650mn from current ~Rs 330-350mn over next three to four years on the back of market expansion and supply of intermediates to other API supplier.



Source: BP Equities Research

CMS-API Pipeline progress Over last six quarters

API

	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Pre Clinical	7	7	9	10	10	11
Phase 1	2	2	4	4	4	4
Phase 2	2	1	2	2	5	6
Phase 3	4	4	4	4	4	6
Development	6	6	5	5	5	4
Commercial	5	5	5	5	6	6
Total	26	25	29	30	34	37

CMS pipeline has more than doubled over last two years and likely to expand at rapid pace going forward

Intermediates

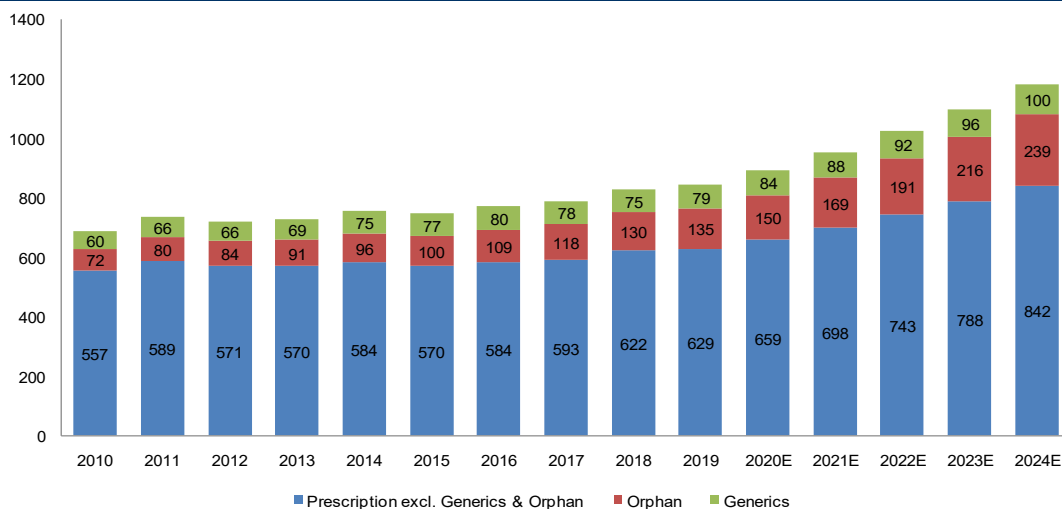
	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Pre Clinical	1	1	0	0	1	1
Phase 1	1	2	2	2	3	3
Phase 2	0	0	0	0	1	1
Phase 3	7	8	6	6	5	5
Development	2	3	7	8	9	11
Commercial	7	7	10	10	10	10
Total	18	21	25	26	29	31

Source: Company Prospectus (CRISIL Research), BP Equities Research

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World wide Total Prescription Drug Sales in 2010-2024 (\$ in bn)



Source: Evaluate Pharma World Preview

World wide Total Pharmaceutical R&D Spend in 2010-2024 (\$ in bn)



Source: Evaluate Pharma World Preview

Worldwide pharmaceutical R&D spend totaled \$179bn in 2018 representing an increase of +6.5% from the previous year. Going forward, R&D spend is forecasted to grow at a CAGR of 3.0% between 2018 and 2024. This is comparable with a CAGR of 4.2% between 2010 and 2018, with an average proportion of R&D spend to pharmaceutical revenue for the same period of 19.8%, compared to 20.2% for 2018-24. Despite an initial peak in 2019, the proportion of R&D spend to pharmaceutical revenue falls quickly in subsequent years. This reduction in R&D spend could be an indication that companies are investing now to improve their future R&D efficiencies. Use of real world data combined with machine learning techniques in addition to collaborative R&D programs, are a few of the initiatives being employed by companies to help them stay a step ahead in an era demanding more patient targeted drug development.

New Molecular Entity (NME) Approvals per Year (2006-2018)

Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Number of NMEs	29	25	31	35	26	35	44	35	51	56	27	55	62
Spend per NME (\$bn)	3.8	4.9	4.2	3.6	4.9	3.9	3.1	4	2.8	2.7	5.9	3.1	2.9
Spend per NME (\$bn) (3 year lag)*				3.2	4.7	3.8	2.9	3.7	2.7	2.4	5.1	2.6	2.4

Source: Evaluate Pharma World Preview

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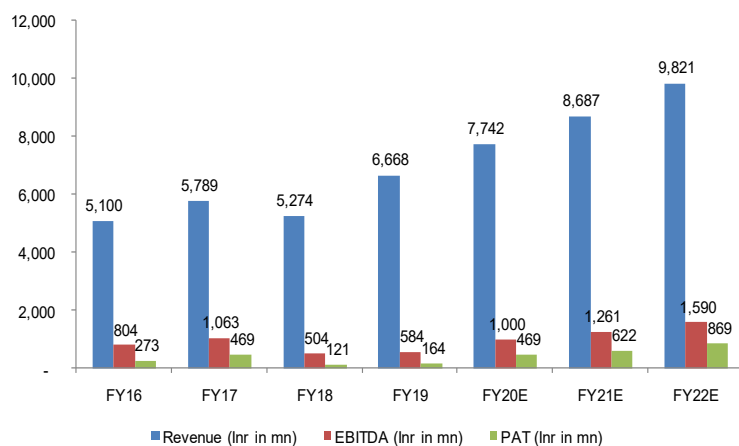
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Financial Performance to improve further

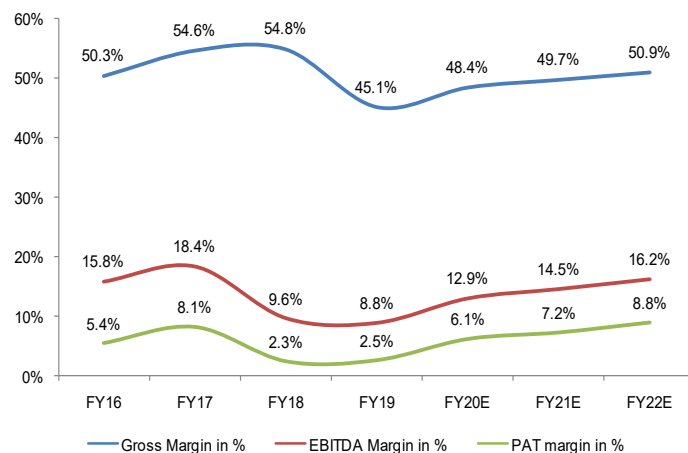
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The EBITDA margin is expected to enhance on the back of recovery in niche APIs and CMS businesses, launch of lucrative projects in the CMS business and operating leverage

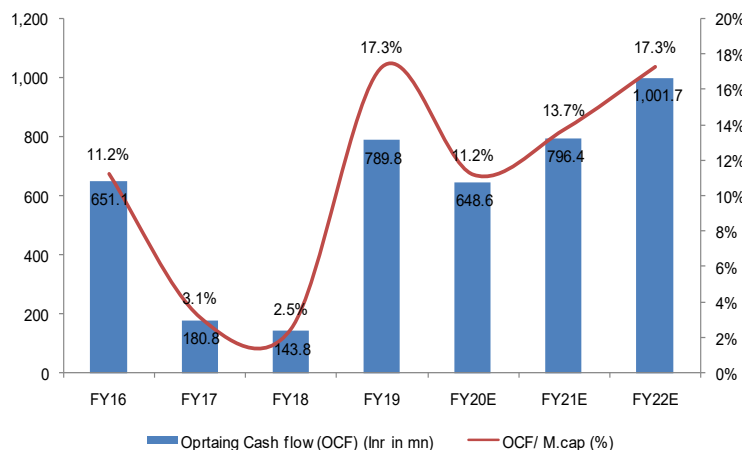
Revenue to grow at healthy pace



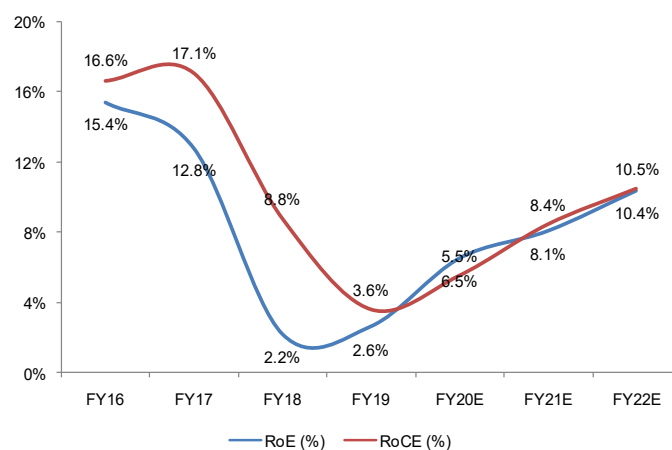
EBITDA margin to improve by 744bps over FY19-22E



Cash flow generation remain strong



Return ratios to recover from lows



Source: Company, Bloomberg, BP Equity Research

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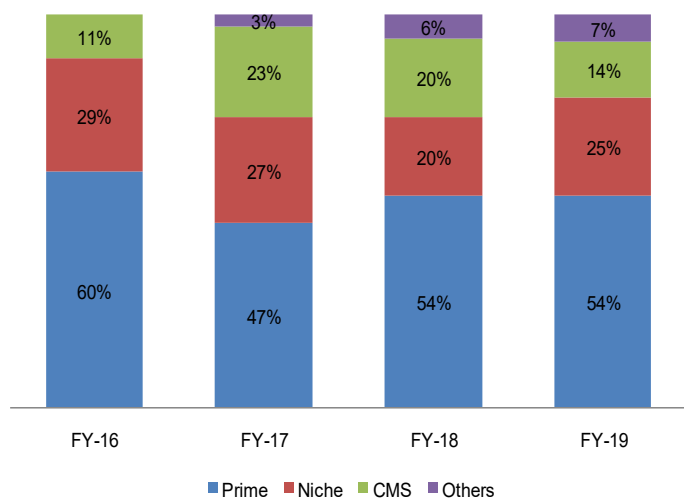
Company Background

Neuland Laboratories Ltd (NLL) was set up as a private limited company in 1984 by Dr. D R Rao and Mr. G V K Rama Rao and it was reconstituted as a public limited company, with the current name, in 1994. NLL is primarily into manufacturing of active pharmaceutical ingredients for global pharmaceutical companies and also provides end-to-end solutions for the pharmaceutical industry for chemistry-related services from synthesis of library compounds to supply of New Chemical Entities (NCEs) and intermediates at various clinical phases up to commercial scale. NLL has three manufacturing facilities in and around Hyderabad, Telangana with total installed capacity of 729.70 Kilo Litre as on March 31, 2019 (222.50 KL in unit I, 310.20 KL in unit II and 197 KL in Unit III). The manufacturing facilities are compliant with health and regulatory agencies cGMP certifications namely, FDA (USA), Canada (HC), PMDA (Japan), KFDA (Korea), EU (EMA), EDQM (COS), ANVISA (Brazil) and others. This apart, the company also provides Custom Manufacturing Solutions (CMS) to develop and manufacture pharmaceutical ingredients and intermediates in line with customer expectations. The company has portfolio of around 50 products with presence in 25 therapeutic segments including Antibacterial, Antidepressant, Bronchodilator, Anticonvulsant, Antipsychotics, Antiparkinsonian, Antihypertensive and Anatomical.

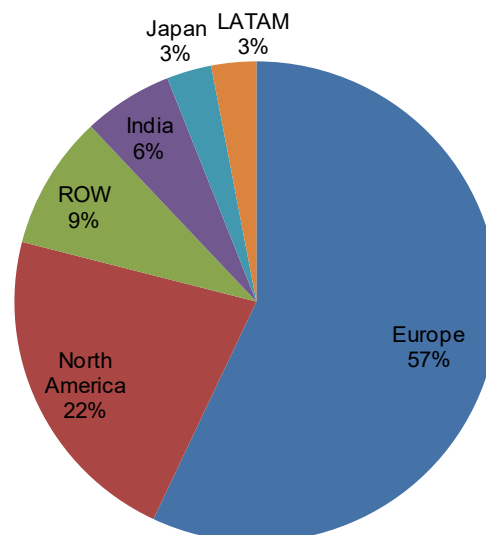
75% of revenues through exports

82% of revenues through regulated markets

Revenue by verticals



Revenue by end territory



Source: Company, BP Equities Research

Manufacturing Facilities

Unit	Bonthapally ,Hyderabad 222.5 KL	Pashamylaram ,Hyderabad 310.2 KL	Gaddapotharam ,Hyderabad 197 KL
Year of establishment	1986	1994	2017*
Revenue share(%)	55-60%	40-45%	NA
Utilisation level	90%	80%	NA
Key products	Mirtazapine, Sotalol Hcl , Levetiracetam, Levofloxacin, Salmeterol,Salbutamol, NCE APIs, Peptide APIs, Vitamin D2 analogues	Ciprofloxacin Hcl , Entacapone , NCE APIs, Intermediates & RSMs	Products including Key Intermediates
Regulatory	USFDA, EDQM, CFDA, PMDA,	USFDA, EDQM, PMDA, ANVISA	Inspected by USFDA in 2015

Source: Company, BP Equities Research

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Key Milestones

1984	Neuland Laboratories is incorporated in Hyderabad
1986	Witnesses first ever API sale of salbutamol sulphate
1994	Goes public with its IPO and raises capital for construction of second production facility
1997	Receives its first US FDA approval
1999	US FDA inspects Neuland's manufacturing facilities, Receives certificate of suitability for Ranitidine
2004	Establishes operations in North America
2007	Establishes a Japan subsidiary in Tokyo
2008	Achieves ISMS certification, Unit 1 is successfully inspected by USFDA and certified for ISO 14001 and OHSAS 18001
2009	Receives approval from PMDA, Japan
2010	Receives certification for ISO 14001:2004 and OHSAS 18001:2007
2014	Strategic alignment towards niche API's and custom manufacturing solutions
2015	Conducts 10th FDA inspection
2016	R&D Facility approved by US FDA
2017	US FDA audit of Unit 1,CFDA audit of Unit 1,EDQM audit of Unit 2
2017	Acquisition of Advanced Intermediates and API facility
2018	US FDA audit of Unit 2

Source: Company, BP Equities Research

Neuland Laboratories Ltd - Management Committee Details

Name	Designation	Details
Dr. Davuluri Rama Mohan Rao	Chairman and Managing Director	He has a Masters in Science degree from Andhra University, Post Graduate Diploma in Technology from IIT Kharagpur and a PhD in Organic Chemistry from the University of Notre Dame, U.S.A. Prior to founding Neuland in 1984, he had held senior positions in R&D, production and quality assurance at Glaxo India for about ten years and was Director, R&D and QA at another Pharmaceutical company. He is a member of the Royal Society of Chemistry.
Mr. Davuluri Sucheth Rao	Vice-Chairman and CEO	He has a degree in Mechanical Engineering and holds an MBA in Corporate Finance and Operations Management from University of Notre Dame, U.S.A. He was Production Group Leader in Cummins Inc., U.S.A. and later went on to become a green belt in Six Sigma. He has been actively involved in managing Neuland since 2002, initially as Chief Operating Officer (COO) and then as CEO.
Mr. Davuluri Saharsh Rao	Joint Managing Director	He is an Electrical Engineering Graduate and obtained his Masters in Management Information Systems from Weatherhead School of Management, Cleveland, Ohio, U.S.A. He also secured Master of Business Administration from University of North Carolina, U.S.A. He has worked in the past with Sify Limited in various roles in the Sales organization. He joined Neuland in 2007, with responsibility for initiating the Custom Manufacturing Solutions (CMS) business. He is currently responsible for all Marketing, Business Development activities along with oversight of R&D.
Dr. Christopher M. Cimarusti	Non-Executive Director	He has completed his PhD in Organic Chemistry from Purdue University, U.S.A. and his Postdoctoral Research from Columbia University, U.S.A. He has more than 40 years of experience in the field of drug discovery, development and manufacturing, been awarded more than 60 patents and published more than 40 papers in referred journals. Dr. Cimarusti held executive leadership positions at Squibb Corporation and Bristol-Myers Squibb (BMS) in discovery and development. His last position with BMS was as Sr. Vice President, Pharmaceutical Development Centre of Excellence.
Mr. Humayun Dhanrajgir	Independent Director	He is a B.Tech, MI, CHEM (E) by qualification. With 45 years' experience in the pharmaceutical industry, he has held several senior positions in Glaxo India, including the roles of Managing Director and Executive Vice-Chairman. He is a past President of Organization of Pharmaceutical Producers of India (OPPI)

Source: Company, BP Equities Research

Neuland Laboratories Ltd.

Initiating Coverage Report

⇒ Peer group comparison

Company	CMP	M Cap	P/E		EPS		EV/EBITDA		RoE (%)	
	(INR)	(INR in Bn)	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Neuland Labs	422	5.4	8.8	6.4	48.2	66.3	5.9	4.7	8.1	10.2
Divi's Labs*	1,835	487.5	28.9	23.8	63.6	77.3	20.5	17.1	19.8	20.4
Laurus Labs*	388	41.5	16.0	12.1	24.3	32.0	8.2	6.9	13.4	15.4
Dishman Carbogen	74	11.9	4.2	3.8	17.5	19.6	2.3	2.1	5.0	5.6

Source: BP Equities Research, * Bloomberg estimate

PE Band - Neuland Laboratories Ltd.



Source: BP Equities Research, Ace Equity

⇒ Key Risks and Concerns:

- ⇒ **Demand risk:** The API business is dependent on the requirement of formulation players, which often causes inconsistency in offtake. Similar is the case for CMS business which keeps fluctuating due to demand variations.
- ⇒ **Quality compliance risk:** The stringent quality norms prescribed by the key regulatory agencies lead to risks of recalls, production delays and ban of manufacturing activities. The company has better track record on the USFDA inspections front compared to its peers.
- ⇒ **Delay in products approvals:** Delay in approvals of finished dosages may lead to a delay in offtake for API and may slow down projects' execution under CMS business. On the other hand, an early genericisation of key drugs may provide an upside risk for the company.

Neuland Laboratories Ltd.

Initiating Coverage Report

Valuation & Outlook

Valuation	Basis	FY20E	FY21E	FY22E
EPS		36	48	66
Growth in EPS (YoY %)		185%	33%	38%
Implied PE		11.6	8.8	6.4
Assigned PE	(10x PE)	10	10	10
Target Price		363	482	663
(Implied PEG Ratio considering next 2.5 years: 1)				
CMP				422
Upside Potential (%)				57%

Source: Company, BP Equities Research

While generic API manufacturing remains the pillar of NLL's overall business the ramp-up in the CMS segment (API CRAMS); especially given the fertile product opportunities (like Bilastine and Peptide product) are expected to drive next phase of growth going forward. We believe NLL will continue to strengthen its balance sheet with strong operating cash flow generation of INR2.45bn over FY19-22E. Considering the expected strong growth in profitability, healthy balance sheet with improving return ratios, we are optimistic about the long-term growth prospects of the company. With washout in FY18 and growth resumption in FY19, we believe that the CMP (down 45% from 52 week high) offers an attractive opportunity for investors to time an entry. We foresee 13.8% revenue CAGR, 744bps margin expansion and 73.2% growth in earnings over FY19-22E. The balance of portfolio among high value and high volume products will help it see a faster growth in earnings. The stock trades at 6.4x FY22e EPS (ten-year average being 20.65x). We believe the stock will see a gradual re-rating on the back of stronger products pipeline and improved return ratios. We assign a valuation multiple of 10x (50% disc to 10 year avg P/E) FY22e EPS. We initiate coverage on the stock & recommend 'BUY' rating with a target price of INR 663 per share.



Neuland Laboratories Ltd.

Initiating Coverage Report

Profit & Loss A/c (Consolidated)							
YE March (INR. Mn)	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
Revenue	5,100	5,789	5,274	6,668	7,742	8,687	9,821
<i>Growth %</i>	8.7%	13.5%	-8.9%	26.4%	16.1%	12.2%	13.1%
Total Revenue	5,100	5,789	5,274	6,668	7,742	8,687	9,821
Less:							
Raw Material Consumed	2,535	2,629	2,384	3,662	3,997	4,373	4,820
Employee Cost	654	927	1,030	1,105	1,215	1,337	1,470
Other Expenses	1,107	1,169	1,356	1,318	1,530	1,717	1,941
Total Operating Expenditure	4,295	4,726	4,770	6,085	6,742	7,426	8,231
EBITDA	804	1,063	504	584	1,000	1,261	1,590
<i>Growth %</i>	20.8%	32.2%	-52.6%	15.7%	71.4%	26.1%	26.1%
Less: Depreciation	157	192	221	259	293	363	400
EBIT	647	871	283	325	708	899	1,190
<i>Growth %</i>	26.1%	34.6%	-67.5%	14.8%	117.7%	27.0%	32.4%
Interest Paid	245	211	189	157	157	157	157
Non-operating Income	18	12	45	35	35	35	35
Extraordinary Income	0	0	0	0	0	0	0
Profit Before tax	420	672	139	203	586	777	1,068
Tax	149	203	19	39	117	155	214
Net Profit	268	469	121	164	469	622	855
Adjusted Profit	268	469	121	164	469	622	855
Reported Diluted EPS Rs	21.2	36.3	9.4	12.7	36.3	48.2	66.3
<i>Growth %</i>	71.3%	71.5%	-74.3%	36.3%	185.1%	32.6%	37.5%
Adjusted Diluted EPS Rs	20.8	36.3	9.4	12.7	36.3	48.2	66.3
<i>Growth %</i>	68.6%	74.6%	-74.3%	36.3%	185.1%	32.6%	37.5%

Source: Ace Equity, BP Equities Research

Common Sized Profit & Loss Account							
YE March (INR. Mn)	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
Total Revenues	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Less:							
Raw Material Consumed	49.7%	45.4%	45.2%	54.9%	51.6%	50.3%	49.1%
Employee Cost	12.8%	16.0%	19.5%	16.6%	15.7%	15.4%	15.0%
Other Expenses	21.7%	20.2%	25.7%	19.8%	19.8%	19.8%	19.8%
Total Operating Expenditure	84.2%	81.6%	90.4%	91.2%	87.1%	85.5%	83.8%
EBITDA	15.8%	18.4%	9.6%	8.8%	12.9%	14.5%	16.2%
Depreciation	3.1%	3.3%	4.2%	3.9%	3.8%	4.2%	4.1%
Interest Paid	4.8%	3.6%	3.6%	2.3%	2.0%	1.8%	1.6%
Non-operating Income	0.3%	0.2%	0.9%	0.5%	0.5%	0.4%	0.4%
Extraordinary Items	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Profit Before Tax	8.2%	11.6%	2.6%	3.0%	7.6%	8.9%	10.9%
Current tax	2.9%	3.5%	0.4%	0.6%	1.5%	1.8%	2.2%
Profit After Tax	5.4%	8.1%	2.3%	2.5%	6.1%	7.2%	8.7%
Adjusted Profit	5.3%	8.1%	2.3%	2.5%	6.1%	7.2%	8.7%

Source: Ace Equity, BP Equities Research

Neuland Laboratories Ltd.

Initiating Coverage Report

Cash Flows (Consolidated)							
YE March (Rs. Mn)	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
PAT	273.2	468.6	120.6	164.4	468.7	621.5	854.8
(Less)/Add: Extraordinary Income/Expense	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Less: Non Operating Income	(17.8)	(11.7)	(45.3)	(34.9)	(34.9)	(34.9)	(34.9)
Add: Depreciation	157.4	192.3	221.0	258.6	292.7	362.7	400.2
Add: Interest Paid	244.8	210.9	189.3	156.6	156.6	156.6	156.6
Tax Adjustment	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operating Profit before Working Capital Changes	657.7	860.1	485.6	544.8	883.2	1,106.0	1,376.7
(Inc)/Dec in Current Assets	175.8	(496.3)	(274.1)	318.7	(347.1)	(305.4)	(366.4)
Inc/(Dec) in Current Liabilities	(49.7)	(98.5)	332.1	102.0	422.8	268.8	322.5
Changes in Inventory	(132.6)	(84.5)	(399.8)	(175.7)	(310.3)	(273.0)	(327.6)
Net Cash Generated From Operations	651.1	180.8	143.8	789.8	648.6	796.4	1,005.2
Cash Flow from Investing Activities							
(Inc)/Dec in Fixed Assets	(281.2)	(1,629.6)	(287.1)	(919.9)	(750.0)	(750.0)	(750.0)
(Inc)/Dec in Capital Work In Progress	9.9	208.8	(1,064.9)	216.2	0.0	0.0	0.0
(Inc)/Dec in Investment (Strategic)	11.0	(20.6)	21.3	(78.4)	94.3	(2.3)	(1.6)
(Inc)/Dec in Investment (Others)	0.0	(228.1)	(0.2)	0.0	0.0	0.0	0.0
Add: Non Operating Income	17.8	11.7	45.3	34.9	34.9	34.9	34.9
(Inc)/Dec in Intangible Assets	(5.0)	2.8	0.0	2.2	0.0	0.0	0.0
Net Cash Flow from/(used in) Investing Activities	(247.5)	(1,655.1)	(1,285.6)	(745.0)	(620.7)	(717.4)	(716.7)
Cash Flow from Financing Activities							
Inc/(Dec) in Total Loans	(75.2)	124.1	1,401.8	(925.1)	0.0	0.0	0.0
Inc/(Dec) in Reserves & Surplus	2.5	12.7	3.6	4,332.7	0.0	0.0	0.0
Inc/(Dec) in Equity	0.0	3,108.5	0.0	(3,069.0)	0.0	0.0	0.0
Dividend Paid	(25.7)	0.0	0.0	(15.4)	(43.9)	(58.2)	(80.0)
Less: Interest Paid	(244.8)	(210.9)	(189.3)	(156.6)	(156.6)	(156.6)	(156.6)
Adjustments	(33.2)	(1,532.3)	(26.6)	(5.5)	0.0	0.0	0.0
Exceptional Item	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Cash Flow from Financing Activities	(376.3)	1,502.1	1,189.5	161.0	(200.5)	(214.8)	(236.7)
Net Inc/Dec in cash equivalents	27.3	27.8	47.6	205.9	(172.7)	(135.9)	51.9
Opening Balance	69.8	97.1	124.9	172.6	378.4	205.7	69.9
Closing Balance Cash and Cash Equivalents	97.1	124.9	172.6	378.4	205.7	69.9	121.7

Source: Ace Equity, , BP Equities Research



Neuland Laboratories Ltd.

Initiating Coverage Report

Balance Sheet (Consolidated)							
YE March(Rs. mn)	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
Liabilities							
Equity Capital	90	90	90	129	129	129	129
Reserves & Surplus	1,777	2,258	2,382	6,864	7,289	7,852	8,627
Equity	1,866	5,456	5,580	6,993	7,418	7,981	8,756
Net Worth	1,866	5,456	5,580	6,993	7,418	7,981	8,756
Minority Interest							
Net Deferred tax liability/(Asset)	240	246	429	433	433	433	433
Total Loans	1,690	1,809	3,027	2,098	2,098	2,098	2,098
Capital Employed	3,797	7,511	9,037	9,524	9,949	10,512	11,287
Assets							
Gross Block	2,918	4,547	4,835	5,754	6,504	7,254	8,004
Less: Depreciation	1,530	190	384	638	930	1,293	1,693
Net Block	1,388	4,357	4,450	5,117	5,574	5,961	6,311
Capital WIP	405	196	1,261	1,045	1,045	1,045	1,045
Investments	227	248	227	305	211	213	215
Others - A	74	302	302	302	302	302	302
Current Assets							
Inventories	1,267	1,351	1,751	1,927	2,237	2,510	2,837
Sundry Debtors	1,191	1,811	1,939	1,640	1,904	2,137	2,416
Cash and Bank Balance	97	125	173	378	206	70	122
Current Investments	0	75	75	75	75	75	75
Loans and Advances	467	253	371	318	369	414	468
Other Current Assets	120	135	163	197	229	257	290
Total Current Assets	3,142	3,750	4,472	4,535	5,019	5,462	6,208
Less: Current Liabilities & Provisions							
Sundry Creditors	839	859	1,243	1,223	1,556	1,746	1,974
Provisions	55	14	16	8	9	10	12
Other Current Liabilities	550	472	418	548	637	714	808
Total Current Liabilities & Provisions	1,444	1,345	1,677	1,779	2,202	2,471	2,793
Capital Applied	3,797	7,511	9,037	9,524	9,949	10,512	11,287

Source: Ace Equity, , BP Equities Research



Key Ratios (Consolidated)

YE March (Rs. mn)	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
Key Operating Ratios							
EBITDA Margin (%)	15.8%	18.4%	9.6%	8.8%	12.9%	14.5%	16.2%
Tax / PBT (%)	35.5%	30.2%	13.4%	19.2%	20.0%	20.0%	20.0%
Net Profit Margin (%)	5.4%	8.1%	2.3%	2.5%	6.1%	7.2%	8.7%
RoE (%)	15.4%	12.8%	2.2%	2.6%	6.5%	8.1%	10.2%
RoCE (%)	16.6%	17.1%	8.8%	3.6%	5.5%	8.4%	10.4%
Current Ratio (x)	2.2x	2.8x	2.7x	2.5x	2.3x	2.2x	2.2x
Dividend Payout (%)	9.4%	0.0%	0.0%	9.4%	9.4%	9.4%	9.4%
Book Value Per Share (Rs.)	144.7	422.9	432.6	542.1	575.0	618.7	678.7
Financial Leverage Ratios							
Debt/ Equity (x)	0.9x	0.3x	0.5x	0.3x	0.3x	0.3x	0.2x
Interest Coverage (x)	3.3x	5.0x	2.7x	3.7x	6.4x	8.1x	10.2x
Growth Indicators %							
Growth in Net Block (%)	12.8%	214.0%	2.1%	15.0%	8.9%	6.9%	5.9%
Sales Growth (%)	8.7%	13.5%	(8.9%)	26.4%	16.1%	12.2%	13.1%
EBITDA Growth (%)	20.8%	32.2%	(52.6%)	15.7%	71.4%	26.1%	26.1%
Net Profit Growth (%)	71.3%	71.5%	(74.3%)	36.3%	185.1%	32.6%	37.5%
Diluted EPS Growth (%)	71.3%	71.5%	(74.3%)	36.3%	185.1%	32.6%	37.5%
Turnover Ratios							
Debtors Days	85	114	134	90	90	90	90
Creditors Days	60	66	95	73	73	73	73
Inventory Days	91	85	121	105	105	105	105

Source: Ace Equity, , BP Equities Research

Research Desk

Tel: +91 22 61596464

Institutional Sales Desk

Tel: +91 22 61596403/04/05

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Analyst (s) holding in the Stock : Nil**Analyst (s) Certification:**

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Corporate Office:

4th floor,
Rustom Bldg,
29, Veer Nariman Road, Fort,
Mumbai-400001
Phone- +91 22 6159 6464
Fax-+91 22 6159 6160
Website- www.bpwealth.com

Registered Office:

24/26, 1st Floor, Cama Building,
Dalal street, Fort,
Mumbai-400001
BP Equities Pvt. Ltd.
CIN No: U67120MH1997PTC107392