

BUY

TP: Rs 1,520 | ▲ 17%

AJANTA PHARMA

Pharmaceuticals

06 May 2023

Margins appear to have bottomed out; raise to BUY

- Strong India and US growth in Q4 (17% YoY each) offset by declines in other businesses
- EBITDA down 28% YoY on flat revenue and weak margins; expect recovery over FY24-FY25 as price erosion ebbs and costs ease
- FY24 EPS cut 3% but FY25 unchanged on anticipated margin revival; post rollover, our TP rises to Rs 1,520 (vs. Rs 1,470) – raise to BUY

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Strong India growth...: Barring India (+17% YoY) and US (+17%) business, AJP's other businesses declined YoY. Strong growth in India was on account of volume gains (+8%), price hikes (+6%) and new launches (+3%). In secondary sales terms as per IQVIA, AJP's growth at 16% was twice that of the Indian pharma market (IPM). Key therapies outperformed the market, including cardiology (+13% vs. +9% IPM), ophthalmology (+16% vs. +16%), dermatology (+26% vs. +6%) and pain management (+23% vs. +12%). Management expects India growth momentum to continue on the back of volumes and price hikes.

...offset by slowdown in emerging markets: Asia/Africa branded businesses declined 9%/26% YoY in Q4. Asia branded business contracted on account of a high base due to pandemic-led buying in Q4FY22. The company expects a return to normal levels of mid-to-high-teens growth in FY24 on the back of a robust pipeline and increased productivity. Africa branded business contracted on account of rupee appreciation against the euro and the strike in France which affected the supply chain.

EBITDA margin hits a bottom; guided to return to 24-25% in FY24: AJP reported one of its lowest ever EBITDA margins at 16.9% (-680bps YoY, -50bps QoQ) on account of higher employee, R&D and other operating costs further exasperated by forex loss. This was on top of subdued gross margin of 72.7% in Q4 vs. at least 75% historically (albeit flat YoY/QoQ in Q4). Management has guided for a return to a 74-75% gross margin and 24-25% EBITDA margin in FY24 given stabilising US price erosion, moderating input/freight costs, and the absence of one-off charges.

Raise to BUY on anticipated margin revival: We expect AJP to post a 10% revenue CAGR over FY23-FY25 with continued momentum in India business, recovery in ex-India business as constraints affecting Africa operations normalise, and mid-teens growth in Asia branded sales. We crop FY24 EPS 3% (FY25 unchanged) and now factor in EBITDA margin expansion of 400bps over FY23-FY25, yielding an earnings CAGR of 18%. On rollover to FY25E, our TP rises from Rs 1,470 to Rs 1,520, based on a lower EV/EBITDA multiple of 11x – 25% discount to stocks 5-year average. Upgrade from HOLD to BUY.

Key changes

Target	Rating
▲	▲

Ticker/Price	AJP IN/Rs 1,298
Market cap	US\$ 2.0bn
Free float	31%
3M ADV	US\$ 1.3mn
52wk high/low	Rs 1,428/Rs 1,067
Promoter/FPI/DII	66%/10%/16%

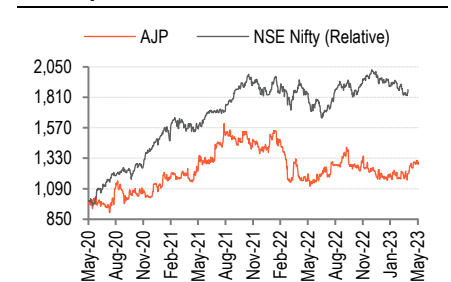
Source: NSE | Price as of 5 May 2023

Key financials

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	37,426	41,638	45,214
EBITDA (Rs mn)	7,832	9,724	11,238
Adj. net profit (Rs mn)	5,879	7,098	8,121
Adj. EPS (Rs)	46.5	56.2	64.3
Consensus EPS (Rs)	46.5	58.8	70.2
Adj. ROAE (%)	17.6	19.3	19.0
Adj. P/E (x)	27.9	23.1	20.2
EV/EBITDA (x)	20.7	16.6	14.3
Adj. EPS growth (%)	(43.9)	20.7	14.4

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	FY23	FY22	YoY (%)
Net Sales	8,818	8,703	1.3	9,718	(9.3)	37,426	33,410	12.0
EBITDA	1,494	2,067	(27.7)	1,696	(11.9)	7,370	9,293	(20.7)
Depreciation	330	312	6.0	333	(0.8)	1,308	1,253	-
EBIT	1,164	1,755	(33.7)	1,363	(14.6)	6,062	8,040	-
Interest	11	73	(84.6)	28	(60.2)	58	102	-
Other Income	368	295	24.9	349	5.4	1,449	1,157	-
PBT	1,521	1,977	(23.1)	1,683	(9.7)	7,453	9,095	(18.1)
Less: Taxation	298	465	(35.9)	338	(11.9)	1,573	1,968	-
Less: Minority Interest	-	-	-	-	-	0	0	-
Recurring PAT	1,223	1,512	(19.1)	1,345	(9.1)	5,880	7,127	(17.5)
Exceptional items	0	0	-	0	-	0	0	-
Reported PAT	1,223	1,512	(19.1)	1,345	(9.1)	5,880	7,127	(17.5)
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	72.7	72.5	18	72.3	40	71.9	75.1	(315)
EBITDA Margin	16.9	23.7	(681)	17.4	(51)	19.7	27.8	(812)
Tax / PBT	19.6	23.5	-	20.1	-	21.1	21.6	-
NPM	13.9	17.4	(351)	13.8	2	15.7	21.3	-
EPS (Rs)	9.7	17.6	-	10.5	-	46.5	83.0	(43.9)

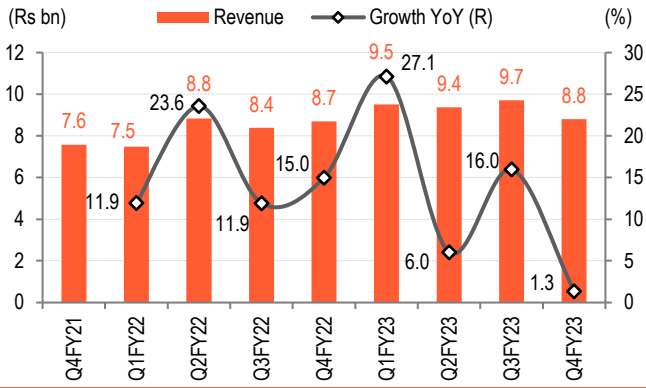
Source: Company, BOBCAPS Research

Fig 2 – Revenue mix

(Rs mn)	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	FY23	FY22	YoY (%)
Domestic Formulation	2,870	2,450	17.1	2,940	(2.4)	11,740	9,780	20.0
Exports Formulation	5,840	6,160	(5.2)	6,700	(12.8)	25,330	23,000	10.1
Africa	1,490	1,860	(19.9)	1,760	(15.3)	7,490	7,910	(5.3)
Asia	2,380	2,620	(9.2)	2,280	4.4	9,570	8,120	17.9
US	1,970	1,680	17.3	2,660	(25.9)	8,270	6,960	18.8
Other op Income	108	93	16.7	78	39.5	356	630	(43.4)
Revenues	8,818	8,703	1.3	9,718	(9.3)	37,426	33,410	12.0
USDINR	82	75	9.2	82	0.0	81	75	9.0
US revenue (US\$ mn)	24	22	7.4	32	(26)	102	93	9.1

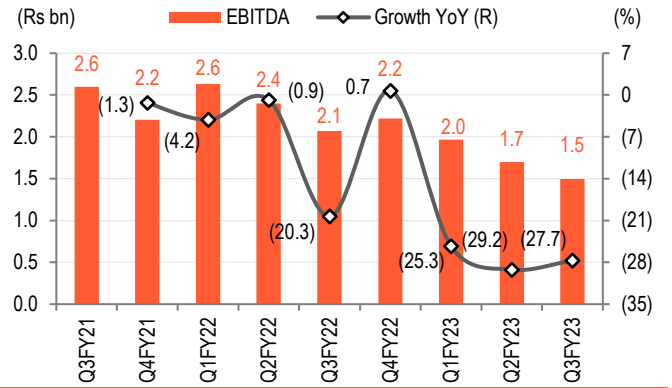
Source: Company, BOBCAPS Research

Fig 3 – Revenue



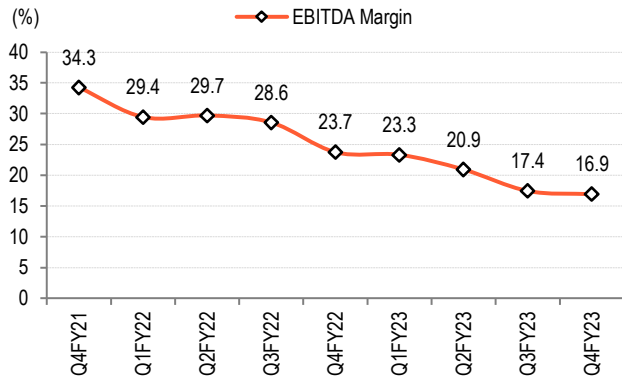
Source: Company, BOBCAPS Research

Fig 4 – EBITDA



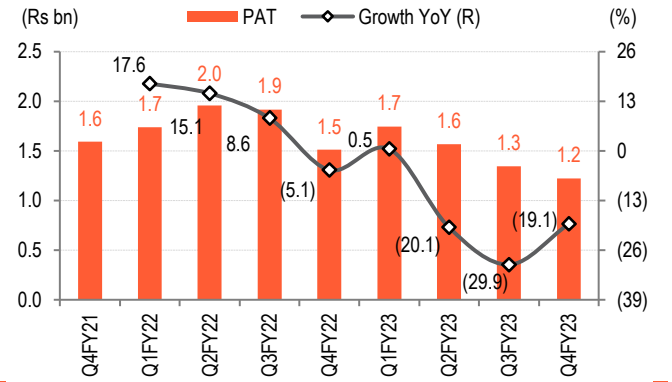
Source: Company, BOBCAPS Research

Fig 5 – EBITDA Margin



Source: Company, BOBCAPS Research

Fig 6 – PAT



Source: Company, BOBCAPS Research

Earnings call highlights

- **India branded:** AJP's India business recorded strong growth of 17% YoY in Q4FY23 on account of volume gains, product launches (23 in Q4 with 6 first-to-market), price hikes and improvement in marketing representative productivity (+20% YoY). India business also included trade generic revenue of Rs 420mn in Q4 against Rs 300mn in the year-ago quarter (Rs 1.5bn in FY23 vs. Rs 1.2bn in FY22). Management expects continued outperformance against the IPM going ahead, primarily from volume and price hike-led gains. Currently, 12% of India business falls under the National List of Essential Medicines (NLEM).
- **US generics:** The 26% QoQ decline in US revenue to US\$ 24mn was because the flu season (~US\$ 10mn from Oseltamivir) led to higher revenue in Q3FY23. Since the flu season has ended, no one-off sales are expected from the US. The company expects to file 6-8 ANDAs in FY24 and launch ~5 products.
- **Africa institutional:** Africa institutional business remained unpredictable as it is dependent on procurement from agencies.
- **Employee cost:** Staff cost jumped 35% YoY in Q4 on account of regrouping of certain expenses (Rs 270mn) from selling expenses to employee costs following the adoption of best practices. Staff incentives will be reported in employee cost going forward.
- **Gross margin:** The FY23 gross margin declined 315bps to 71.9% on account of high material cost during the year, price erosion in the US, one-time inventory write-off and rupee appreciation against the euro which amounted to ~3%. With US price erosion down to single digits now, the USDINR back to normal and moderation in raw material prices, AJP expects gross margin to return to historical levels of 74-75% in FY24.
- **EBITDA margin:** EBITDA margin in Q4FY23 at 16.9% was impacted by a forex loss of Rs 220mn (19.4% ex-loss). FY23 saw elevated logistics cost which impacted the EBITDA margin by ~200bps. Improvement in gross margin, the absence of one-time charges seen in FY23 and moderating freight costs are guided to result in EBITDA margin of 24-25% in FY24.
- **R&D:** R&D expenses remained at 7%/6% of revenue in Q4/FY23 with no significant changes expected.
- **Tax Rate:** The effective tax rate remained at 21% for FY23, and AJP does not see any change for FY24.
- **Capex:** The company incurred capex of Rs 1.6bn in FY23 and has guided for Rs 2bn in FY24 including maintenance capex, new office building and some capacity enhancement.

Valuation methodology

We expect AJP to post a 10% revenue CAGR over FY23-FY25 aided by continued momentum in India business, recovery in ex-India business as supply chain constraints affecting Africa operations normalise, and mid-teens growth in Asia branded sales.

We crop our FY24 EPS estimate by 3% (FY25 unchanged) and now factor in EBITDA margin expansion of 400bps over FY23-FY25, yielding an earnings CAGR of 18%. On rollover to FY25E, our TP rises from Rs 1,470 to Rs 1,520, based on a lower EV/EBITDA multiple of 11x (vs 12x earlier) – 25% discount to stocks 5-year average. Upgrade from HOLD to BUY.

Fig 7 – Revised estimates

(Rs bn)	New		Old		Change (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Sales	41.6	45.2	41.4	NA	0.5	-
EBITDA	9.7	11.2	10.4	NA	(6.1)	-
EBITDA margin (%)	23.4	24.9	25.0	NA	(165 bps)	-
EPS (Rs)	56.2	64.3	57.9	NA	(3.0)	-

Source: BOBCAPS Research

Fig 8 – Key assumptions

Revenue (Rs bn)	FY23A	FY24E	FY25E
India	11.7	13.2	14.6
Africa	7.5	8.1	8.8
Asia	9.6	10.5	11.6
US	8.3	9.2	9.6
Other Op. Income	0.3	0.6	0.7

Source: Company, BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- raw material and freight costs staying elevated,
- escalation in US price erosion,
- adverse USFDA observations affecting new launches in the US,
- INR appreciation vs. the EUR, and
- persisting Africa supply chain constraints.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.0	1,298	1,520	BUY
Alembic Pharma	ALPM IN	1.3	555	615	HOLD
Alkem Labs	ALKEM IN	5.1	3,466	3,000	SELL
Aurobindo Pharma	ARBP IN	4.3	599	635	BUY
Cipla	CIPLA IN	9.1	925	1,250	BUY
Divi's Labs	DIVI IN	10.7	3,291	3,200	HOLD
Dr Reddy's Labs	DRRD IN	10.1	4,943	4,700	HOLD
Eris Lifesciences	ERIS IN	1.0	626	810	BUY
Glenmark Life Sciences	GLS IN	0.8	517	600	BUY
Laurus Labs	LAURUS IN	2.1	316	340	HOLD
Lupin	LPC IN	3.9	704	700	HOLD
Sun Pharma	SUNP IN	28.5	970	1,100	HOLD

Source: BOBCAPS Research, NSE | Price as of 5 May 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Total revenue	28,897	33,410	37,426	41,638	45,214
EBITDA	10,192	9,293	7,832	9,724	11,238
Depreciation	1,161	1,253	1,308	1,417	1,522
EBIT	9,031	8,040	6,524	8,307	9,715
Net interest inc./(exp.)	(83)	(102)	(58)	(21)	(21)
Other inc./(exp.)	251	1,157	986	699	718
Exceptional items	0	0	0	0	0
EBT	9,199	9,095	7,452	8,985	10,412
Income taxes	2,463	1,968	1,573	1,887	2,291
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	6,736	7,127	5,879	7,098	8,121
Adjustments	0	0	0	0	0
Adjusted net profit	6,736	7,127	5,879	7,098	8,121

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Accounts payables	3,739	3,272	4,228	4,563	4,955
Other current liabilities	2,677	3,070	6,967	3,747	4,069
Provisions	296	301	382	425	461
Debt funds	198	250	356	356	356
Other liabilities	0	0	0	0	0
Equity capital	174	172	253	253	253
Reserves & surplus	30,203	32,935	33,637	39,315	45,812
Shareholders' fund	30,377	33,107	33,889	39,568	46,065
Total liab. and equities	37,286	40,000	45,823	48,582	55,829
Cash and cash eq.	2,096	2,118	3,387	3,618	8,994
Accounts receivables	7,384	10,198	10,569	10,267	11,149
Inventories	7,665	7,911	8,156	9,696	10,529
Other current assets	1,891	1,656	1,375	2,082	2,261
Investments	1,846	1,554	5,354	5,354	5,354
Net fixed assets	15,214	14,946	14,887	15,470	15,447
CWIP	1,082	1,529	2,095	2,095	2,095
Intangible assets	108	90	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	37,286	40,000	45,823	48,582	55,829

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Cash flow from operations	5,971	5,590	11,842	3,750	8,522
Capital expenditures	(728)	(895)	(1,600)	(2,000)	(1,500)
Change in investments	(1,051)	292	(3,800)	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(1,780)	(603)	(5,400)	(2,000)	(1,500)
Equities issued/Others	(2)	(2)	81	0	0
Debt raised/repaid	(238)	53	106	0	0
Interest expenses	(83)	(102)	(58)	(21)	(21)
Dividends paid	(826)	(816)	(884)	(1,420)	(1,624)
Other financing cash flows	(2,997)	(4,098)	(4,418)	0	0
Cash flow from financing	(4,145)	(4,965)	(5,174)	(1,441)	(1,646)
Chg in cash & cash eq.	47	22	1,269	309	5,376
Closing cash & cash eq.	2,096	2,118	3,387	3,696	8,994

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23P	FY24E	FY25E
Reported EPS	76.8	83.0	46.5	56.2	64.3
Adjusted EPS	77.5	83.0	46.5	56.2	64.3
Dividend per share	9.5	9.5	7.0	11.2	12.9
Book value per share	346.4	377.5	386.4	451.2	525.3

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23P	FY24E	FY25E
EV/Sales	5.6	4.9	4.3	3.9	3.6
EV/EBITDA	16.0	17.5	20.7	16.6	14.3
Adjusted P/E	16.8	15.6	27.9	23.1	20.2
P/BV	3.7	3.4	3.4	2.9	2.5

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23P	FY24E	FY25E
Tax burden (Net profit/PBT)	73.2	78.4	78.9	79.0	78.0
Interest burden (PBT/EBIT)	101.9	113.1	114.2	108.2	107.2
EBIT margin (EBIT/Revenue)	31.3	24.1	17.4	20.0	21.5
Asset turnover (Rev./Avg TA)	25.1	26.1	27.7	28.1	26.2
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	23.7	22.5	17.6	19.3	19.0

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23P	FY24E	FY25E
YoY growth (%)					
Revenue	11.7	15.6	12.0	11.3	8.6
EBITDA	49.1	(8.8)	(15.7)	24.2	15.6
Adjusted EPS	44.0	7.2	(43.9)	20.7	14.4
Profitability & Return ratios (%)					
EBITDA margin	35.3	27.8	20.9	23.4	24.9
EBIT margin	31.3	24.1	17.4	20.0	21.5
Adjusted profit margin	23.3	21.3	15.7	17.0	18.0
Adjusted ROAE	23.7	22.5	17.6	19.3	19.0
ROCE	32.2	28.8	22.2	24.3	24.2
Working capital days (days)					
Receivables	93	111	103	90	90
Inventory	97	86	80	85	85
Payables	47	36	41	40	40
Ratios (x)					
Gross asset turnover	1.4	1.6	1.7	1.7	1.7
Current ratio	2.8	3.3	2.0	2.9	3.5
Net interest coverage ratio	109.2	78.8	111.7	388.6	454.5
Adjusted debt/equity	(0.1)	(0.1)	(0.1)	(0.1)	(0.2)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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BUY – Expected return >+15%

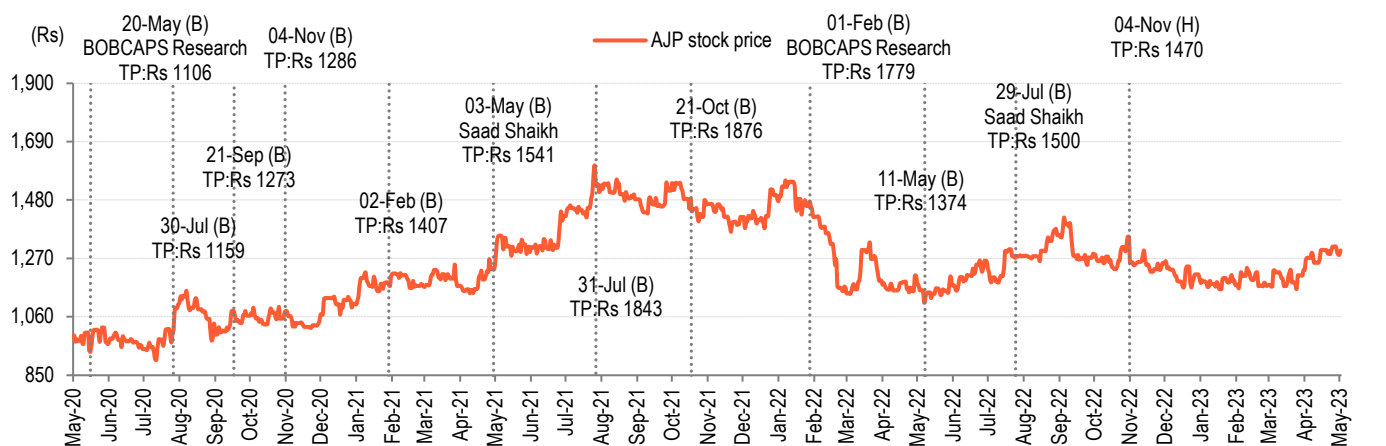
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): AJANTA PHARMA (AJP IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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