

BUY

TP: Rs 1,920 | ▲ 19%

AJANTA PHARMA

Pharmaceuticals

04 November 2020

Exceptional Q2 beat; H2 momentum to moderate

Ajanta Pharma (AJP) posted Q2 revenue/EBITDA growth of 11%/54% YoY to Rs 7.2bn/Rs 2.7bn. EBITDA margin expanded YoY and QoQ to 38.3% due to higher gross margins and continued subdued SGA spends. Branded Africa sales were a beat and India/Asia/US were in line. Reported PAT was Rs 1.7bn. AJP expects a muted H2 on SGA cost normalisation and higher RM cost. The board has approved a Rs 1.4bn (0.84% of equity) share buyback. We raise FY22-FY23 EPS by 3% each; our Sep'21 TP moves to Rs 1,920 (vs. Rs 1,900). BUY.

Vivek Kumar

research@bobcaps.in

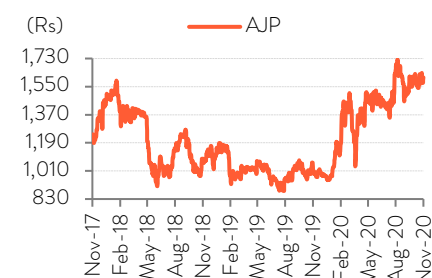
Africa branded sales beat estimates; India/Asia/US in line: India sales growth was muted (flat YoY, +16% QoQ) due to subdued recovery in the acute portfolio (dermatology, ophthalmology) while the chronic segment did well. In export formulations, branded Africa sales grew at a strong 37% YoY (+27% in H1) but Asia was muted (+11% in H1). We continue to see good visibility in exports with two blocks operationalised in Q4. US sales were at US\$ 21mn (+3% QoQ). AJP expects healthy H2 launches (Tamiflu susp., Divalproex DR).

Ticker/Price	AJP IN/Rs 1,609
Market cap	US\$ 1.9bn
Shares o/s	88mn
3M ADV	US\$ 3.8mn
52wk high/low	Rs 1,760/Rs 903
Promoter/FPI/DII	71%/9%/9%

Source: NSE

EBITDA margin beat sustainable: Q2 saw subdued costs across SGA, R&D and staff heads (-2% QoQ) along with gross margin expansion of ~1ppt QoQ to 78.3%, driving EBITDA margins of 38% (36% in H1). Margin gains could reverse in H2 on higher RM cost and promotional spends (virtually nil in Q2), as well as slower branded EM business (Asia, Africa) due to Covid restrictions.

STOCK PERFORMANCE



Source: NSE

Retain BUY: We continue to expect a stable brand franchise (India and EM), US operating leverage and capex moderation to drive a 25%+ EPS CAGR for AJP over FY21-FY23. Over 75% of FY22/FY23 EPS is estimated to accrue from the branded business. Further, with improving FCF and 34%+ ROIC beyond FY23E, we believe the stock has scope for valuation upsides.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	20,553	25,878	27,199	31,046	35,317
EBITDA (Rs mn)	5,653	6,944	8,367	9,096	10,688
Adj. net profit (Rs mn)	3,869	4,082	5,453	6,350	7,839
Adj. EPS (Rs)	44.1	46.6	62.2	72.4	89.4
Adj. EPS growth (%)	(17.4)	5.5	33.6	16.5	23.4
Adj. ROAE (%)	17.8	16.6	19.0	19.0	20.0
Adj. P/E (x)	36.5	34.6	25.9	22.2	18.0
EV/EBITDA (x)	24.8	20.2	16.7	15.2	12.7

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	Q2FY21E	Var. (%)	H1FY21	H1FY20	YoY (%)
Net Sales	7,159	6,427	11.4	6,682	7.1	7,035	1.8	13,841	12,546	10.3
EBITDA	2,744	1,778	54.3	2,235	22.8	2,143	28.0	4,979	3,463	43.8
Depreciation	283	233	-	280	-	280	-	563	460	-
EBIT	2,461	1,545	59.3	1,955	25.9	1,863	-	4,416	3,003	47.1
Interest	15	49	-	16	-	16	-	31	67	-
Other Income	49	132	-	131	-	131	-	180	208	-
PBT	2,495	1,628	53.2	2,070	20.5	1,978	26.1	4,564	3,144	45.2
Less: Taxation	789	451	-	589	-	514	-	1,378	819	-
Less: Minority Interest	-	-	-	-	-	-	-	0	0	-
Recurring PAT	1,706	1,177	44.9	1,481	15.2	1,464	16.5	3,186	2,325	37.0
Exceptional items	0	(11)	-	0	-	0	-	0	(11)	-
Reported PAT	1,706	1,166	46.2	1,481	15.2	1,464	16.5	3,186	2,314	37.7
Key Ratios (%)										
Gross Margin	78.3	74.1	-	77.1	-	74.5	-	77.7	75.4	-
EBITDA Margin	38.3	27.7	-	33.4	-	30.5	-	36.0	27.6	-
Tax / PBT	31.6	27.7	-	28.5	-	26.0	-	30.2	26.0	-
NPM	23.8	18.3	-	22.2	-	20.8	-	23.0	18.5	-
EPS (Rs)	19.4	13.4	-	16.9	-	16.7	-	36.3	26.5	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	Q2FY21E	Var. (%)	H1FY21	H1FY20	YoY (%)
Domestic Formulation	2,020	2,030	(0.5)	1,740	16.1	1,971	2.5	3,760	3,970	(5.3)
Export Formulation	4,988	4,470	11.6	4,800	3.9	4,944	0.9	9,788	8,510	15.0
Africa	1,644	1,540	6.8	1,700	(3.3)	1,361	20.8	3,344	3,270	2.3
Asia	1,804	1,810	(0.3)	1,610	12.0	1,955	(7.7)	3,414	3,070	11.2
US	1,540	1,110	38.7	1,490	3.4	1,628	(5.4)	3,030	2,130	42.3
Others/LATAM	-	10	-	0	-	-	-	-	40	-
Other Op Income	151	30	403.3	142	6.3	120	26	293	106	176.4
Revenues	7,159	6,530	9.6	6,682	7.1	7,035	1.8	13,841	12,586	10.0
INR/USD	74	70	6	74	0.0	74	-	74	70	5.7
US revenue in USD terms	21	16	31	20	3.4	22	(5.4)	41	30	34.6

Source: Company, BOBCAPS Research

Valuation methodology

AJP has a strong track record in terms of rational capital allocation, building a brand franchise, flawless cGMP compliance and stable returns ratios. We believe the branded generic franchise (India and EM) is robust and likely to remain resilient – this alongside operating leverage in the US business should drive an accelerated 25%+ EPS CAGR over FY21-FY23 (vs. flat growth for FY18-FY20).

In FY18, the company embarked on a major capex drive worth Rs 11bn towards augmenting formulation capacity, which is now nearing an end and should fuel a doubling of current sales, per management. We expect improved FCF momentum over the next 2-3 years based on healthy earnings growth and a normalised capex run-rate of Rs 1bn-1.25bn annually. ROIC levels are thus forecast to expand from 26% in FY20 to 34% by FY23.

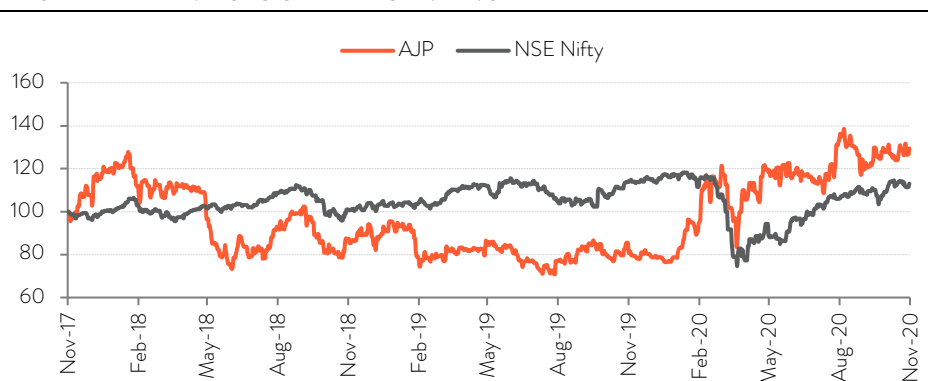
We increase our FY22/FY23 EPS estimates by 3% each to factor in higher EBITDA margin assumptions on cost optimisation in the India business. At CMP, the stock is trading at 13x FY23E EBITDA (15% below the 10-year mean and 40% below the 10-year high) and 18x P/E which looks attractive in the context of ROIC improvement. We retain BUY with a revised Sep'21 target price of Rs 1,920 (from Rs 1,900), set at an unchanged 16x one-year forward EV/EBITDA multiple (24x implied P/E).

FIG 3 – REVISED ESTIMATES

(Rs bn)	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Sales	27.2	31.0	35.3	27.2	31.0	35.3	0.0	0.0	0.0
EBITDA	8.4	9.1	10.7	7.6	8.9	10.4	10.1	2.5	2.4
EBITDA margin (%)	30.8	29.3	30.3	27.9	28.6	29.5	283bps	73bps	72bps
EPS (Rs)	62	72	89	56	70	87	11.5	3.3	3.2

Source: Company, BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Concentration and regulatory risk in India business:** AJP's domestic formulation business is concentrated around three key therapies – ophthalmology, cardiology and dermatology – which drive 90% of sales. Any adverse regulatory action here can slow down overall business momentum. Current portfolio under price control is at 13% of India sales vs. 16% for industry.
- **US execution:** We estimate that the US business will contribute a third of our EPS over the next three years. This is mainly dependent on two key units – Paithan (~90% of existing US sales) and Dahej (future growth driver). Establishment inspection reports (EIR) for both units are in place (last inspected in Jul-Aug'19). Thus, strong cGMP compliance is key.
- **Slower offtake in branded generic exports:** Currency devaluation and repatriation concerns will lead to slower growth in branded generics markets.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	20,553	25,878	27,199	31,046	35,317
EBITDA	5,653	6,944	8,367	9,096	10,688
Depreciation	720	957	1,104	1,181	1,264
EBIT	4,933	5,987	7,263	7,915	9,424
Net interest income/(expenses)	(12)	(119)	(52)	(78)	(78)
Other income/(expenses)	210	176	362	630	968
Exceptional items	0	0	0	0	0
EBT	5,132	6,044	7,573	8,467	10,314
Income taxes	1,263	1,962	2,121	2,117	2,475
Extraordinary items	0	595	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	3,869	4,677	5,453	6,350	7,839
Adjustments	0	595	0	0	0
Adjusted net profit	3,869	4,082	5,453	6,350	7,839

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	2,252	3,622	2,981	3,402	3,870
Other current liabilities	944	1,831	1,360	1,552	1,766
Provisions	383	246	259	295	336
Debt funds	340	436	1,300	1,300	1,300
Other liabilities	0	0	0	0	0
Equity capital	175	175	175	175	175
Reserves & surplus	22,545	26,398	30,760	35,840	42,111
Shareholders' fund	22,721	26,573	30,935	36,016	42,287
Total liabilities and equities	26,640	32,708	36,835	42,565	49,559
Cash and cash eq.	1,004	2,049	4,806	8,219	12,649
Accounts receivables	4,594	7,753	6,707	7,655	8,708
Inventories	4,357	4,956	5,589	6,379	7,257
Other current assets	1,510	1,211	2,176	2,484	2,825
Investments	776	794	794	794	794
Net fixed assets	11,719	14,509	14,763	15,034	15,324
CWIP	2,613	1,318	2,000	2,000	2,000
Intangible assets	67	117	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	26,640	32,707	36,835	42,565	49,559

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	4,589	5,634	6,557	7,532	9,103
Interest expenses	12	119	52	78	78
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(186)	(1,339)	(1,651)	(1,396)	(1,550)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	4,414	4,415	4,958	6,213	7,631
Capital expenditures	(1,930)	(3,294)	(1,358)	(1,453)	(1,555)
Change in investments	1,123	(18)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(807)	(3,313)	(1,358)	(1,453)	(1,555)
Equities issued/Others	(2)	0	0	0	0
Debt raised/repaid	330	96	865	0	0
Interest expenses	(12)	(119)	(52)	(78)	(78)
Dividends paid	(795)	(816)	(1,091)	(1,270)	(1,568)
Other financing cash flows	(3,055)	783	(565)	0	0
Cash flow from financing	(3,533)	(57)	(843)	(1,348)	(1,646)
Changes in cash and cash eq.	74	1,045	2,757	3,412	4,430
Closing cash and cash eq.	1,004	2,049	4,806	8,219	12,649

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	44.1	53.3	62.2	72.4	89.4
Adjusted EPS	44.1	46.6	62.2	72.4	89.4
Dividend per share	9.0	9.3	12.4	14.5	17.9
Book value per share	259.1	303.0	352.7	410.7	482.2

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	6.8	5.4	5.1	4.5	3.8
EV/EBITDA	24.8	20.2	16.7	15.2	12.7
Adjusted P/E	36.5	34.6	25.9	22.2	18.0
P/BV	6.2	5.3	4.6	3.9	3.3

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	75.4	67.5	72.0	75.0	76.0
Interest burden (PBT/EBIT)	104.0	101.0	104.3	107.0	109.4
EBIT margin (EBIT/Revenue)	24.0	23.1	26.7	25.5	26.7
Asset turnover (Revenue/Avg TA)	23.5	25.8	23.0	22.3	21.8
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	17.8	16.6	19.0	19.0	20.0

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	(3.6)	25.9	5.1	14.1	13.8
EBITDA	(14.1)	22.8	20.5	8.7	17.5
Adjusted EPS	(17.4)	5.5	33.6	16.5	23.4
Profitability & Return ratios (%)					
EBITDA margin	27.5	26.8	30.8	29.3	30.3
EBIT margin	24.0	23.1	26.7	25.5	26.7
Adjusted profit margin	18.8	15.8	20.0	20.5	22.2
Adjusted ROAE	17.8	16.6	19.0	19.0	20.0
ROCE	23.5	24.6	25.7	24.6	25.7
Working capital days (days)					
Receivables	82	109	90	90	90
Inventory	77	70	75	75	75
Payables	40	51	40	40	40
Ratios (x)					
Gross asset turnover	1.3	1.3	1.3	1.4	1.5
Current ratio	3.2	2.8	4.2	4.7	5.3
Net interest coverage ratio	425.3	50.3	139.5	101.5	120.8
Adjusted debt/equity	0.0	(0.1)	(0.1)	(0.2)	(0.3)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: AJANTA PHARMA (AJP IN)



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

Rating distribution

As of 31 October 2020, out of 88 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 42 have BUY ratings, 14 have ADD ratings, 10 are rated REDUCE and 22 are rated SELL. None of these companies have been investment banking clients in the last 12 months.

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2020. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations

expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities — that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have “long” or “short” positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.