

HOLD

TP: Rs 1,470 | ▲ 9%

AJANTA PHARMA

Pharmaceuticals

04 November 2022

No respite from margin pressure; cut to HOLD

- Q2 revenue growth muted at 6% YoY as lower Africa/US sales offset a strong uptick in India/Asia business
- High freight costs, US price erosion and adverse currency impact drove an 875bps YoY drop in EBITDA margin to 20.9%
- We lower margin estimates and revise our TP to Rs 1,470 (vs. Rs 1500) – cut from BUY to HOLD on limited upside potential

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Subdued growth as Africa/US business declines: AJP posted muted Q2FY23 revenue growth of 6% YoY to Rs 9.4bn. The India and Asia branded businesses (+31% YoY) performed well on the back of 15 launches during H1FY23, with healthy volume-driven growth in the domestic formulations business (+27% YoY). However, growth was offset by lower sales in the African market (-20% YoY) and a steep drop in other operating income (-65% YoY).

US business remains flat; regulatory clearance at Dahej holds the key: US revenue for the quarter was flat QoQ at US\$ 23mn owing to sustained price erosion coupled with a lack of new approvals as the Dahej (Gujarat) plant remains under regulatory scrutiny. Management is hopeful of USFDA clearance (procedural observations) and expects to file 10-12 products in FY23 (3 filed so far in H1).

Adverse currency movement hurts Africa business: Africa branded sales (16% of Q2 revenue) declined 8% YoY due to INR appreciation vs. the EUR (Africa business denominated in euros). AJP earns most of its export revenue in dollars and a small portion in euros. Per management, it is difficult to hike prices in Africa to counter adverse forex movement, and improved hedging is the only way to mitigate the impact.

High operating cost exacts toll on margins: Increased raw material cost, US price erosion and elevated freight cost took a toll on EBITDA margin which contracted 875bps YoY to 20.9% in Q2 – the lowest quarterly margin in three years. Font-loading of some costs (R&D, promotional) further dampened margins. Management has reduced margin guidance from 26-27% for FY23 to 25-27% for H2 (H1 at 22.1%).

Cut to HOLD: Given the steady fall in EBITDA margin to 22.1% in H1FY23 vs. a ~30% average until recently and management's guidance cut, we lower our FY23-FY24 margin estimates 70-100bps to 24-25%. We continue to value the stock at 12x FY24E EV/EBITDA, ~20% discount to the 5Y average, yielding a TP of Rs 1,470 (vs. Rs 1,500). In our view, the stock holds limited upside given sustained margin stress and a weak US outlook, prompting our downgrade from BUY to HOLD. Sustained domestic/Asia branded growth and pickup in US filings/approvals would fuel stock upsidess.

Key changes

Target	Rating
▼	▼

Ticker/Price	AJP IN/Rs 1,348
Market cap	US\$ 2.1bn
Free float	31%
3M ADV	US\$ 1.3mn
52wk high/low	Rs 2,354/Rs 1,112
Promoter/FPI/DII	70%/9%/12%

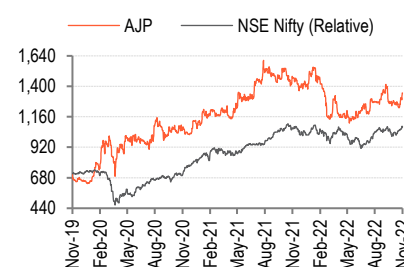
Source: NSE | Price as of 3 Nov 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	33,410	37,858	41,438
EBITDA (Rs mn)	9,293	9,224	10,361
Adj. net profit (Rs mn)	7,127	6,415	7,440
Adj. EPS (Rs)	83.0	49.9	57.9
Consensus EPS (Rs)	83.0	57.2	66.9
Adj. ROAE (%)	22.5	17.9	17.9
Adj. P/E (x)	16.2	27.0	23.3
EV/EBITDA (x)	18.5	18.6	16.4
Adj. EPS growth (%)	7.2	(39.9)	16.0

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Net Sales	9,381	8,848	6.0	9,509	(1.3)	18,890	16,328	15.7
EBITDA	1,963	2,628	(25.3)	2,218	(11.5)	4,181	4,830	(13.4)
Depreciation	327	315	3.7	318	2.9	645	624	-
EBIT	1,636	2,313	(29.2)	1,900	(13.9)	3,536	4,206	(15.9)
Interest	10	4	147.5	9	12.5	19	19	-
Other Income	404	295	36.6	328	23.2	731	622	-
PBT	2,030	2,604	(22.0)	2,219	(8.5)	4,249	4,809	(11.6)
Less: Taxation	464	645	(28.0)	472	(1.8)	(936)	(1,112)	-
Less: Minority Interest	-	-	-	-	-	-	-	-
Recurring PAT	1,566	1,959	(20.1)	1,746	(10.3)	3,312	3,697	(10.4)
Exceptional items	0	0	-	0	-	0	0	-
Reported PAT	1,566	1,959	(20.1)	1,746	(10.3)	3,312	3,697	(10.4)
Key Ratios (%)								
Gross Margin	72.3	73.8	(144)	70.5	180	71.4	75.3	(386)
EBITDA Margin	20.9	29.7	(877)	23.3	(239)	22.1	29.6	(745)
Tax / PBT	22.9	24.8	-	21.3	-	(22.0)	(23.1)	-
NPM	16.7	22.1	(545)	18.4	(167)	17.5	22.6	-
EPS (Rs)	12.2	15.2	-	13.6	-	25.8	28.8	-

Source: Company, BOBCAPS Research

Fig 2 – Segmental performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Domestic formulations	3,140	2,480	26.6	2,790	12.5	5,930	4,770	24.3
Exports formulations	6,150	6,110	0.7	6,640	(7.4)	12,790	11,210	14.1
Africa	1,790	2,250	(20.4)	2,450	(26.9)	4,240	4,020	5.5
Asia	2,510	1,910	31.4	2,400	4.6	4,910	3,560	37.9
US	1,850	1,940	(4.6)	1,790	3.4	3,640	3,620	0.6
Other operating income	91	258	(64.7)	79	14.8	170	348	(51.0)
Revenues	9,381	8,848	6.0	9,509	(1.3)	18,890	16,328	15.7
USDINR	81	74	9.7	79	2.9	80	74	8.5
US revenue (US\$ mn)	23	26	(13.1)	23	0.5	45	49	(7.3)

Source: Company, BOBCAPS Research

Earnings call highlights:

- **Branded generics:** AJP's branded generics business contributed 75% of revenue in Q2FY23, including 32% from India and 43% from exports (27% from Asia and 16% from Africa). The company launched 15 new products in H1FY23 (including 3 first-to-market) in the branded generics markets of India and Asia.
- **India:** Domestic formulation growth was at 27% YoY (+13% QoQ) on the back of product launches, market share gains and price increases. Management expects India to clock growth in the high teens in FY23.
- **Trade generics:** Revenue in trade generics increased 27% YoY to Rs 380mn in Q2 (+25% to Rs 710mn in H1), contributing 12% to the domestic business.
- **US:** Due to price erosion in the US market and the absence of product launches, US revenue stayed flat QoQ at US\$ 23mn in Q2. AJP continues to have 39 products on the shelf and expects high-single-digit growth in FY23. The company received one final and one tentative approval in H1FY23. It filed 3 products in H1 and expects to file a total of 10-12 for FY23, with as many as 21 ANDAs awaiting USFDA approval.
- **Reduced pace of ANDA approvals due to regulatory hurdles:** The company is unable to garner new product approvals in the US due to two USFDA observations (Sep'22) on its Dahej facility. Since these are procedural in nature, management expects an establishment inspection report (EIR) followed by a pickup in approvals over the coming months.
- **Africa branded business:** Africa branded business (16% of Q2 revenue) declined 8% YoY due to the impact of rupee appreciation vs. the euro. AJP earns a majority of its export revenue in dollars and a small portion in euros. Per management, it is difficult to take price increases in Africa to counter adverse currency movement, and improved hedging is the only way to mitigate the impact.
- **Africa institutional:** The Africa institutional business (4% of Q2 revenue) declined 50% YoY and remains unpredictable due to the dependence on procurement agencies, funding and requirements of donor countries.
- **Gross margin:** Sustained inflation in inputs and packaging materials impacted gross margin (-145bps YoY). Sequential improvement (+180bps) was led by a one-time inventory-related write-off in Q1.
- **EBITDA margin:** EBITDA margin contracted 875bps YoY and 240bps QoQ on account of inflation in raw material/packaging costs, higher freight cost (~Rs 240mn impact in Q2), as well as front-loading of R&D and promotional expenses. Freight cost has climbed to 9% of export revenue from 3% earlier due to global factors (3-4x rise in container cost/sea shipment). Management has reduced margin guidance from 26-27% for FY23 to 25-27% for H2FY23 (H1 margin at 22.1%).
- **R&D:** R&D for Q2 was Rs 690mn (6.3% of revenue) and the company expects spends to remain at 6-8% levels for FY23.
- **Capex:** AJP spent Rs 200mn on capex in Q2 (Rs 630mn in H1) and expects to incur a total of Rs 1.5bn in FY23 (vs Rs. 2bn stated earlier).

Valuation methodology

Given the steady fall in EBITDA margin to 22.1% in H1FY23 vs. an average of ~30% until recently and management's guidance cut, we lower our FY23-FY24 operating margin estimates by 70-100bps to 24-25%. We continue to value the stock at 12x FY24E EV/EBITDA, ~20% discount to the five-year average multiple, yielding a TP of Rs 1,470 (vs. Rs 1,500). In our view, the stock holds limited upside potential given sustained margin stress and a weak US business outlook, prompting our rating downgrade from BUY to HOLD.

Fig 3 – Revised estimates

(Rs bn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	37.9	41.4	37.5	40.7	1.0	1.7
EBITDA	9.2	10.4	9.4	10.6	(1.7)	(2.3)
EBITDA Margin (%)	24.4	25.0	25.0	26.0	(67bps)	(103bps)
EPS (Rs)	49.9	57.9	50.1	57.4	(0.4)	0.9

Source: BOBCAPS Research

Fig 4 – Key assumptions

Revenue (Rs bn)	FY22	FY23E	FY24E
India	9.8	11.1	12.4
Africa	7.9	8.7	9.4
Asia	8.1	9.8	10.7
US	7.0	7.9	8.3
Others	0.0	0.0	0.0
OOI	0.6	0.4	0.7

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY22-24E (%)	EV/EBITDA (x)		ROCE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Ajanta Pharma	AJP IN	HOLD	1,470	5.6	12.2	10.8	21.2	21.3	12.0
Alkem Labs	ALKEM IN	HOLD	3,220	7.9	19.7	15.6	16.6	19.7	15.0
Alembic Pharma	ALPM IN	HOLD	770	14.6	8.9	7.8	12.4	16.0	11.0

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- **Concentration and regulatory risk in India business:** AJP's domestic formulation business is concentrated around three key therapies – ophthalmology, cardiology and dermatology – which drive most of the sales. Any adverse regulatory action here can slow down overall business momentum. The current portfolio under price control contributes 12% of its India sales.
- **US price erosion:** Continued high competitive intensity may hurt US business.
- **Slower offtake in branded generic exports:** Currency devaluation and repatriation concerns could lead to slower growth in branded generics markets.

Key upside risks are:

- **Speedy approvals:** Faster-than-expected pickup in US approvals/launches with Dahej plant clearance represents an upside risk to our estimates.
- **Favourable currency:** Stabilisation in the INR vs. EUR and pickup in Africa tender business would take growth ahead of expectations.
- **Waning margin pressure**

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.1	1,348	1,470	HOLD
Alembic Pharma	ALPM IN	1.6	658	770	HOLD
Alkem Labs	ALKEM IN	4.8	3,296	3,220	HOLD
Aurobindo Pharma	ARBP IN	3.9	558	695	BUY
Divi's Labs	DIVI IN	12.1	3,781	4,250	HOLD
Dr Reddy's Labs	DRRD IN	9.2	4,590	4,700	HOLD
Eris Lifesciences	ERIS IN	1.2	728	970	BUY
Glenmark Life Sciences	GLS IN	0.6	435	535	BUY
Laurus Labs	LAURUS IN	3.1	478	540	HOLD
Lupin	LPC IN	3.9	712	600	SELL
Sun Pharma	SUNP IN	30.2	1,044	1,100	HOLD

Source: BOBCAPS Research, NSE | Price as of 3 Nov 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Total revenue	25,878	28,897	33,410	37,858	41,438
EBITDA	6,833	10,192	9,293	9,224	10,361
Depreciation	957	1,161	1,253	1,278	1,361
EBIT	5,876	9,031	8,040	7,946	9,001
Net interest inc./(exp.)	(119)	(83)	(102)	(15)	(15)
Other inc./(exp.)	921	251	1,157	294	553
Exceptional items	0	0	0	0	0
EBT	6,678	9,199	9,095	8,224	9,538
Income taxes	1,962	2,463	1,968	1,809	2,098
Extraordinary items	39	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	4,756	6,736	7,127	6,415	7,440
Adjustments	39	0	0	0	0
Adjusted net profit	4,716	6,736	7,127	6,415	7,440

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Accounts payables	3,622	3,739	3,272	4,149	4,541
Other current liabilities	1,831	2,677	3,070	1,893	2,072
Provisions	246	296	301	341	374
Debt funds	436	198	250	250	250
Other liabilities	0	0	0	0	0
Equity capital	175	174	172	257	257
Reserves & surplus	26,398	30,203	32,935	38,365	44,316
Shareholders' fund	26,573	30,377	33,107	38,622	44,574
Total liab. and equities	32,708	37,286	40,000	45,255	51,811
Cash and cash eq.	2,049	2,096	2,118	5,354	9,767
Accounts receivables	7,753	7,384	10,198	9,335	10,218
Inventories	4,956	7,665	7,911	8,816	9,650
Other current assets	1,211	1,891	1,656	3,029	3,315
Investments	794	1,846	1,554	1,554	1,554
Net fixed assets	14,509	15,214	14,946	15,168	15,307
CWIP	1,318	1,082	1,529	2,000	2,000
Intangible assets	117	108	90	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	32,707	37,286	40,000	45,255	51,811

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Cash flow from operations	4,414	5,971	5,590	6,032	7,416
Capital expenditures	(3,294)	(1,550)	(1,540)	(1,500)	(1,500)
Change in investments	(18)	(1,051)	292	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(3,313)	(2,601)	(1,248)	(1,500)	(1,500)
Equities issued/Others	0	(2)	(2)	85	0
Debt raised/repaid	96	(238)	53	0	0
Interest expenses	(119)	(83)	(102)	(15)	(15)
Dividends paid	(1,140)	(826)	(816)	(900)	(1,488)
Other financing cash flows	1,107	(2,175)	(3,453)	(467)	0
Cash flow from financing	(56)	(3,323)	(4,320)	(1,296)	(1,503)
Chg in cash & cash eq.	1,045	47	22	3,236	4,413
Closing cash & cash eq.	2,049	2,096	2,118	5,354	9,767

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22A	FY23E	FY24E
Reported EPS	53.3	76.8	83.0	49.9	57.9
Adjusted EPS	53.8	77.5	83.0	49.9	57.9
Dividend per share	13.0	9.5	9.5	7.0	11.6
Book value per share	303.0	346.4	377.5	440.4	508.3

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22A	FY23E	FY24E
EV/Sales	6.7	6.0	5.1	4.5	4.1
EV/EBITDA	25.2	16.9	18.5	18.6	16.4
Adjusted P/E	25.1	17.4	16.2	27.0	23.3
P/BV	4.4	3.9	3.6	3.1	2.7

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22A	FY23E	FY24E
Tax burden (Net profit/PBT)	70.6	73.2	78.4	78.0	78.0
Interest burden (PBT/EBIT)	113.6	101.9	113.1	103.5	106.0
EBIT margin (EBIT/Revenue)	22.7	31.3	24.1	21.0	21.7
Asset turnover (Rev./Avg TA)	25.8	25.1	26.1	26.2	24.8
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	19.1	23.7	22.5	17.9	17.9

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
YoY growth (%)					
Revenue	25.9	11.7	15.6	13.3	9.5
EBITDA	20.9	49.1	(8.8)	(0.7)	12.3
Adjusted EPS	21.9	44.0	7.2	(39.9)	16.0
Profitability & Return ratios (%)					
EBITDA margin	26.4	35.3	27.8	24.4	25.0
EBIT margin	22.7	31.3	24.1	21.0	21.7
Adjusted profit margin	18.2	23.3	21.3	16.9	18.0
Adjusted ROAE	19.1	23.7	22.5	17.9	17.9
ROCE	27.2	32.2	28.8	22.8	22.8
Working capital days (days)					
Receivables	109	93	111	90	90
Inventory	70	97	86	85	85
Payables	51	47	36	40	40
Ratios (x)					
Gross asset turnover	1.3	1.4	1.5	1.6	1.6
Current ratio	2.8	2.8	3.3	4.2	4.7
Net interest coverage ratio	49.4	109.2	78.8	529.1	599.3
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%

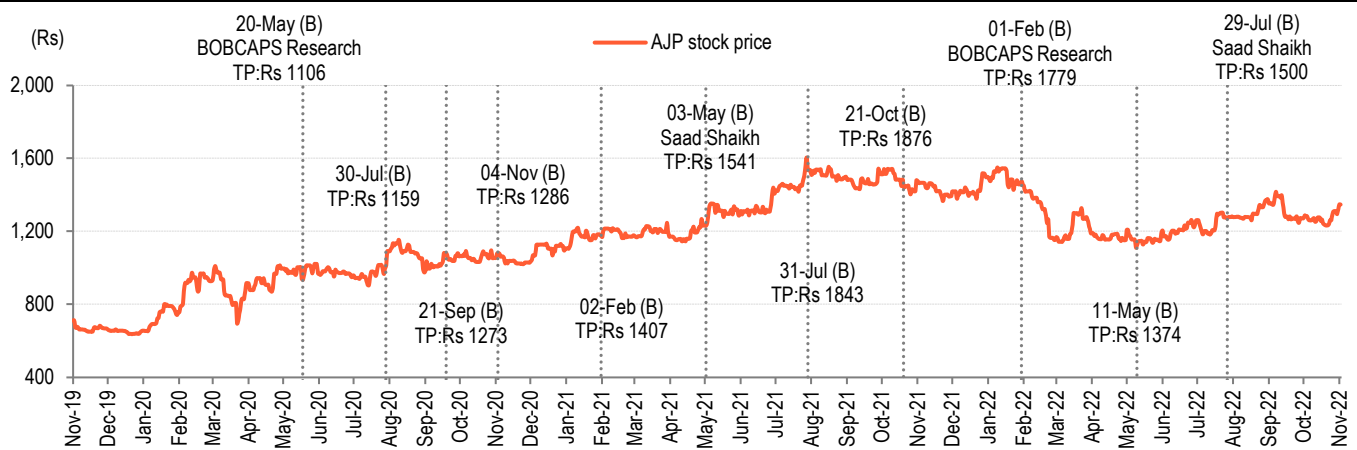
HOLD – Expected return from -6% to +15%

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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