

**BUY**

TP: Rs 2,050 | ▲ 24%

**AJANTA PHARMA**

Pharmaceuticals

11 May 2022

**Margin stress continues**

- Q4 revenue 6% ahead of our estimate but margins disappointed with gross/EBITDA margin contraction of 530bps/1050bps YoY to ~72%/24%
- RM inflation and US price erosion continued to take a toll on margins; FY23 gross/EBITDA margins guided at 75%/28%
- We cut FY23-FY24 EBITDA 9-11% and pare our EV/EBITDA multiple to 15x (vs. 17x), yielding a new TP of Rs 2,050 (vs. Rs 2,655); retain BUY

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**Asia and India led the growth:** AJP's Q4FY22 revenue of Rs 8.7bn was 6% ahead of our estimate led by a strong focus on branded sales in Asia (+50% YoY) and India formulations (+12% YoY). US sales remained lacklustre. With price hikes taken in India from April, management expects the domestic market to continue to perform well for the company.

**US launches delayed due to pending inspections:** US generics revenue grew only 1.2% QoQ in Q4 as strong headwinds in core portfolio pricing largely negated the growth in volumes. AJP's earlier launch guidance has been delayed due to pending approvals as the USFDA has not yet fully resumed plant inspections.

**Margins pressure continues:** AJP reported Q4 gross/EBITDA margin declines of 530bps/1,050bps YoY to 72.5%/23.7%. Gross margin contracted due to higher raw material cost, price erosion in the US (~150bps impact) and a one-time hit from the of two products (150bps). US price erosion has risen to ~18% for the company in Q4 vs. the normal average of 10%. Per management, pricing is now stabilising and should have a reduced impact as the company launches more products from the pending pipeline. For FY22, AJP's EBITDA margin contracted 670bps.

**FY23 revenue guided to grow in mid-teens; margin to remain flat:** Management has guided for mid-teens growth in the FY23 topline. However, it expects margins to remain at FY22 levels of ~28% as the industry continues to see higher input costs as well as a return of other costs to pre-Covid levels.

**Maintain BUY, TP revised to Rs 2,050:** We reduce our FY23-FY24 EBITDA estimates by 9-11% in light of margin pressure arising from raw material cost inflation, US price erosion and expenses retracing to normal levels. Given these headwinds, we also lower our target FY24E EV/EBITDA multiple to 15x (vs. 17x), translating to a reduced TP of Rs 2,050 (vs. Rs 2,655). Maintain BUY as we find branded EM franchise robust and valuation attractive at 14x/12x FY23E/24E EV/EBITDA vs 5-year average of 20x.

**Key changes**

Target	Rating
▼	◀ ▶

Ticker/Price	AJP IN/Rs 1,658
Market cap	US\$ 1.8bn
Free float	31%
3M ADV	US\$ 1.9mn
52wk high/low	Rs 2,435/Rs 1,631
Promoter/FPI/DII	70%/9%/12%

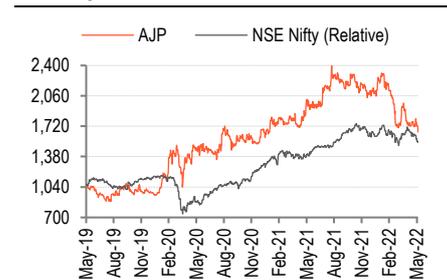
Source: NSE | Price as of 10 May 2022

**Key financials**

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	33,410	37,073	40,328
EBITDA (Rs mn)	9,293	10,393	11,508
Adj. net profit (Rs mn)	7,127	7,223	8,106
Adj. EPS (Rs)	81.3	82.4	92.4
Consensus EPS (Rs)	83.2	99.5	111.9
Adj. ROAE (%)	22.5	20.1	19.2
Adj. P/E (x)	20.4	20.1	17.9
EV/EBITDA (x)	15.1	13.5	12.1
Adj. EPS growth (%)	5.8	1.3	12.2

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

**Stock performance**



Source: NSE



**Fig 1 – Quarterly performance**

(Rs mn)	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)	FY22	FY21	YoY (%)
<b>Net Sales</b>	<b>8,703</b>	<b>7,568</b>	<b>15.0</b>	<b>8,379</b>	<b>3.9</b>	<b>33,410</b>	<b>28,897</b>	<b>15.6</b>
<b>EBITDA</b>	<b>2,067</b>	<b>2,594</b>	<b>(20.3)</b>	<b>2,396</b>	<b>(13.7)</b>	<b>9,293</b>	<b>9,986</b>	<b>(6.9)</b>
Depreciation	312	306	1.8	317	(1.8)	1,253	1,161	-
<b>EBIT</b>	<b>1,755</b>	<b>2,288</b>	<b>(23.3)</b>	<b>2,079</b>	<b>(15.6)</b>	<b>8,040</b>	<b>8,825</b>	<b>-</b>
Interest	73	26	186.7	10	672.6	102	83	-
Other Income	295	25	1065.2	240	22.7	1,157	260	-
<b>PBT</b>	<b>1,977</b>	<b>2,288</b>	<b>(13.6)</b>	<b>2,309</b>	<b>(14.4)</b>	<b>9,095</b>	<b>9,002</b>	<b>1.0</b>
Less: Taxation	465	695	(33.2)	392	18.6	1,968	2,463	-
Less: Minority Interest	-	-	-	-	-	0	0	-
<b>Recurring PAT</b>	<b>1,512</b>	<b>1,593</b>	<b>(5.1)</b>	<b>1,918</b>	<b>(21.2)</b>	<b>7,127</b>	<b>6,539</b>	<b>9.0</b>
Exceptional items	0	0	-	0		0	0	-
<b>Reported PAT</b>	<b>1,512</b>	<b>1,593</b>	<b>(5.1)</b>	<b>1,918</b>	<b>(21.2)</b>	<b>7,127</b>	<b>6,539</b>	<b>9.0</b>
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
Gross Margin	72.5	77.8	(531)	77.4	(494)	75.1	77.7	(259)
EBITDA Margin	23.7	34.3	(1053)	28.6	(484)	27.8	34.6	(674)
Tax / PBT	23.5	30.4	-	17.0	-	21.6	27.4	-
NPM	17.4	21.0	(367)	22.9	(551)	21.3	22.6	-
EPS (Rs)	17.4	18.3	-	22.1	-	81	75	9.0

Source: Company, BOBCAPS Research

**Fig 2 – Segmental mix**

(Rs mn)	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)	FY22	FY21	YoY (%)
Domestic Formulation	2,450	2,180	12.4	2,560	(4.3)	9,780	8,140	20.1
Exports Formulation	6,160	5,260	17.1	5,630	9.4	23,000	20,294	13.3
Africa	1,860	1,790	3.9	2,030	(8.4)	7,910	6,810	16.2
Asia	2,620	1,740	50.6	1,940	35.1	8,120	7,114	14.1
US	1,680	1,730	(2.9)	1,660	1.2	6,960	6,370	9.3
Other op Income	93	128	(27.6)	189	(50.9)	630	478	31.7
<b>Revenues</b>	<b>8,703</b>	<b>7,568</b>	<b>15.0</b>	<b>8,379</b>	<b>3.9</b>	<b>33,410</b>	<b>28,912</b>	<b>15.6</b>
USDINR	75	73	3.2	75	0.4	75	74	0.7
US revenue (US\$ mn)	22	24	(5.9)	22	0.8	93	86	8.5

Source: Company, BOBCAPS Research

## Earnings call takeaways

- **Branded sales focus:** AJP's added focus on branded sales in EMs (mainly Africa and Asia) and on India formulations drove sales growth in Q4FY22. US generics revenue grew only 1.2% QoQ as strong headwinds in core portfolio pricing largely negated the growth in volumes.
- **Guidance for FY23:** Management has guided for consolidated sales growth in the mid-teens and EBITDA margin to be maintained at ~28%. While AJP expects higher input costs to impact Q1FY23, it has guided for a 75% gross profit margin. The company expects COGS to be restricted to 25% of sales as its strong focus on launches and higher sales reach of branded generics in EMs and India will likely offset margin loss in US generics in FY23.
- **US generics:** US generics grew 1.2% QoQ in Q4 but declined 2.9% YoY due to price erosion from strong competition in old products and the core portfolio. AJP plans to file 10-12 ANDAs (vs. 8 in FY22), has launched 3 products and received approval for 2. It expects similar price competition to continue in FY23 as current annual price erosion is 18% vs. normalised levels of 8-10%.
- **R&D expense:** R&D expense is guided to remain at 7% of sales in FY23, with 55% to be spent on US generics and the balance on development of branded generics in India and EMs.
- **NLEM portfolio in India:** The NLEM portfolio receives benefits of a 10.3% price rise, in line with FY22 inflation (WPI), and the portfolio currently contributes 20% of India formulation revenue. NPPA allowed companies a maximum price increase of 10% in the non-NLEM portfolio in case of higher input prices.
- **Capex:** AJP incurred Rs 1.5bn of capex in FY22 and plans to spend Rs 2bn in FY23 including maintenance outlay.
- **Working capital:** Inventory days declined to 88 (vs. 98 days YoY) in FY22 while receivable days increased to 113 (vs. 95 days YoY). Management guided that similar working capital days will be maintained in FY23 as business and overhead costs have normalised post pandemic in India and EMs.

## Valuation methodology

We reduce our FY23-FY24 EBITDA estimates by 9-11% in light of margin pressure arising from raw material cost inflation, US price erosion and expenses retracing to pre-pandemic levels. Given these headwinds, we also lower our target FY24E EV/EBITDA multiple to 15x (vs. 17x), translating to a reduced TP of Rs 2,050 (vs. Rs 2,655). AJP is currently trading at 14x/12x on FY23/24 EV/EBITDA well below 5-year average of 20x. Maintain BUY as we believe the branded generic franchise (India and EM) is robust and likely to remain resilient – this alongside improving FCF/EBITDA conversion with nearing of capex and strong ROIC of 31% should result in rerating going forward.

**Fig 3 – Revised estimates**

(Rs bn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	37.1	40.3	37.3	42.4	(0.7)	(4.8)
EBITDA	10.4	11.5	11.4	13.0	(9.2)	(11.4)
EBITDA Margin (%)	28.0	28.5	30.7	30.7	(262bps)	(212bps)
EPS (Rs)	83.1	92.4	96.8	110.7	(14.2)	(16.5)

Source: BOBCAPS Research

**Fig 4 – Key assumptions**

(Rs bn)	FY22A	FY23E	FY24E
India Formulation	9.8	10.9	12.1
Africa	7.9	9.0	9.8
Asia	8.1	8.9	9.8
US	7.0	7.5	7.9
Others	0.0	0.0	0.0
OOI	0.6	0.6	0.6

Source: Company, BOBCAPS Research

**Fig 5 – Peer comparison**

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY21-24E (%)	EV/EBITDA (x)		ROE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Ajanta Pharma	AJP IN	BUY	2,050	4.1	13.4	12.1	20.1	19.2	15.0
Alkem Labs	ALKEM IN	BUY	4,000	5.7	14.0	12.3	22.8	21.7	17.0
Alembic Pharma	ALPM IN	HOLD	770	3.2	9.6	8.5	11.5	15.0	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 90% of sales. Any adverse regulatory action here can slow down overall business momentum. The current portfolio under price control contributes 20% of its India sales.

- 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, better cGMP compliance is key.
- Slower offtake in branded generic exports:** Currency devaluation and repatriation concerns could lead to slower growth in branded generics markets.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	1.8	1,658	2,050	BUY
Alembic Pharma	ALPM IN	1.8	719	770	HOLD
Alkem Labs	ALKEM IN	4.6	2,972	4,000	BUY
Aurobindo Pharma	ARBP IN	4.6	603	850	BUY
Cipla	CIPLA IN	9.6	926	1,200	BUY
Divi's Labs	DIVI IN	14.8	4,296	5,250	BUY
Dr Reddy's Labs	DRRD IN	8.4	3,914	4,700	HOLD
Eris Lifesciences	ERIS IN	1.2	669	970	BUY
Laurus Labs	LAURUS IN	3.7	526	645	HOLD
Lupin	LPC IN	4.2	714	800	HOLD
Sun Pharma	SUNP IN	26.7	862	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 10 May 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
<b>Total revenue</b>	<b>25,878</b>	<b>28,897</b>	<b>33,410</b>	<b>37,073</b>	<b>40,328</b>
EBITDA	6,833	10,192	9,293	10,393	11,508
Depreciation	957	1,161	1,253	1,292	1,388
EBIT	5,876	9,031	8,040	9,102	10,120
Net interest inc./(exp.)	(119)	(83)	(102)	(15)	(15)
Other inc./(exp.)	921	251	1,157	294	561
Exceptional items	0	0	0	0	0
EBT	6,678	9,199	9,095	9,380	10,665
Income taxes	1,962	2,463	1,968	2,157	2,560
Extraordinary items	39	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
<b>Reported net profit</b>	<b>4,756</b>	<b>6,736</b>	<b>7,127</b>	<b>7,223</b>	<b>8,106</b>
Adjustments	39	0	0	0	0
<b>Adjusted net profit</b>	<b>4,716</b>	<b>6,736</b>	<b>7,127</b>	<b>7,223</b>	<b>8,106</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Accounts payables	3,622	3,739	3,272	4,063	4,420
Other current liabilities	1,831	2,677	3,070	1,854	2,016
Provisions	246	296	301	334	364
Debt funds	436	198	250	250	250
Other liabilities	0	0	0	0	0
Equity capital	175	174	172	172	172
Reserves & surplus	26,398	30,203	32,935	38,732	45,250
Shareholders' fund	26,573	30,377	33,107	38,903	45,422
<b>Total liab. and equities</b>	<b>32,708</b>	<b>37,286</b>	<b>40,000</b>	<b>45,404</b>	<b>52,472</b>
Cash and cash eq.	2,049	2,096	2,118	5,456	10,591
Accounts receivables	7,753	7,384	10,198	9,141	9,944
Inventories	4,956	7,665	7,911	8,633	9,392
Other current assets	1,211	1,891	1,656	2,966	3,226
Investments	794	1,846	1,554	1,554	1,554
Net fixed assets	14,509	15,214	14,946	15,654	15,766
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
<b>Total assets</b>	<b>32,707</b>	<b>37,286</b>	<b>40,000</b>	<b>45,404</b>	<b>52,472</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
<b>Cash flow from operations</b>	<b>4,414</b>	<b>5,971</b>	<b>5,590</b>	<b>7,161</b>	<b>8,236</b>
Capital expenditures	(3,294)	(1,550)	(1,540)	(2,000)	(1,500)
Change in investments	(18)	(1,051)	292	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(3,313)</b>	<b>(2,601)</b>	<b>(1,248)</b>	<b>(2,000)</b>	<b>(1,500)</b>
Equities issued/Others	0	(2)	(2)	0	0
Debt raised/repaid	96	(238)	53	0	0
Interest expenses	(119)	(83)	(102)	(15)	(15)
Dividends paid	(943)	(1,347)	(1,407)	(1,426)	(1,587)
Other financing cash flows	910	(1,654)	(2,861)	(381)	0
<b>Cash flow from financing</b>	<b>(56)</b>	<b>(3,323)</b>	<b>(4,320)</b>	<b>(1,823)</b>	<b>(1,602)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>1,045</b>	<b>47</b>	<b>22</b>	<b>3,338</b>	<b>5,134</b>
<b>Closing cash &amp; cash eq.</b>	<b>2,049</b>	<b>2,096</b>	<b>2,118</b>	<b>5,456</b>	<b>10,591</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22P	FY23E	FY24E
Reported EPS	53.3	76.8	81.3	82.4	92.4
Adjusted EPS	53.8	76.8	81.3	82.4	92.4
Dividend per share	10.8	15.5	16.4	16.6	18.5
Book value per share	303.0	346.4	377.5	443.6	517.9

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22P	FY23E	FY24E
EV/Sales	5.5	4.9	4.2	3.8	3.4
EV/EBITDA	20.7	13.9	15.1	13.5	12.1
Adjusted P/E	30.8	21.6	20.4	20.1	17.9
P/BV	5.5	4.8	4.4	3.7	3.2

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22P	FY23E	FY24E
Tax burden (Net profit/PBT)	70.6	73.2	78.4	77.0	76.0
Interest burden (PBT/EBIT)	113.6	101.9	113.1	103.1	105.4
EBIT margin (EBIT/Revenue)	22.7	31.3	24.1	24.6	25.1
Asset turnover (Rev./Avg TA)	25.8	25.1	26.1	25.6	23.8
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
<b>Adjusted ROAE</b>	<b>19.1</b>	<b>23.7</b>	<b>22.5</b>	<b>20.1</b>	<b>19.2</b>

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22P	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	25.9	11.7	15.6	11.0	8.8
EBITDA	20.9	49.1	(8.8)	11.8	10.7
Adjusted EPS	21.9	42.8	5.8	1.3	12.2
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	26.4	35.3	27.8	28.0	28.5
EBIT margin	22.7	31.3	24.1	24.6	25.1
Adjusted profit margin	18.2	23.3	21.3	19.5	20.1
Adjusted ROAE	19.1	23.7	22.5	20.1	19.2
ROCE	27.2	32.2	28.8	25.9	25.2
<b>Working capital days (days)</b>					
Receivables	109	93	111	90	90
Inventory	70	97	86	85	85
Payables	51	47	36	40	40
<b>Ratios (x)</b>					
Gross asset turnover	1.3	1.4	1.5	1.5	1.6
Current ratio	2.8	2.8	3.3	4.2	4.9
Net interest coverage ratio	49.4	109.2	78.8	606.0	673.8
<b>Adjusted debt/equity</b>	<b>(0.1)</b>	<b>(0.1)</b>	<b>(0.1)</b>	<b>(0.1)</b>	<b>(0.2)</b>

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

## Disclaimer

### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

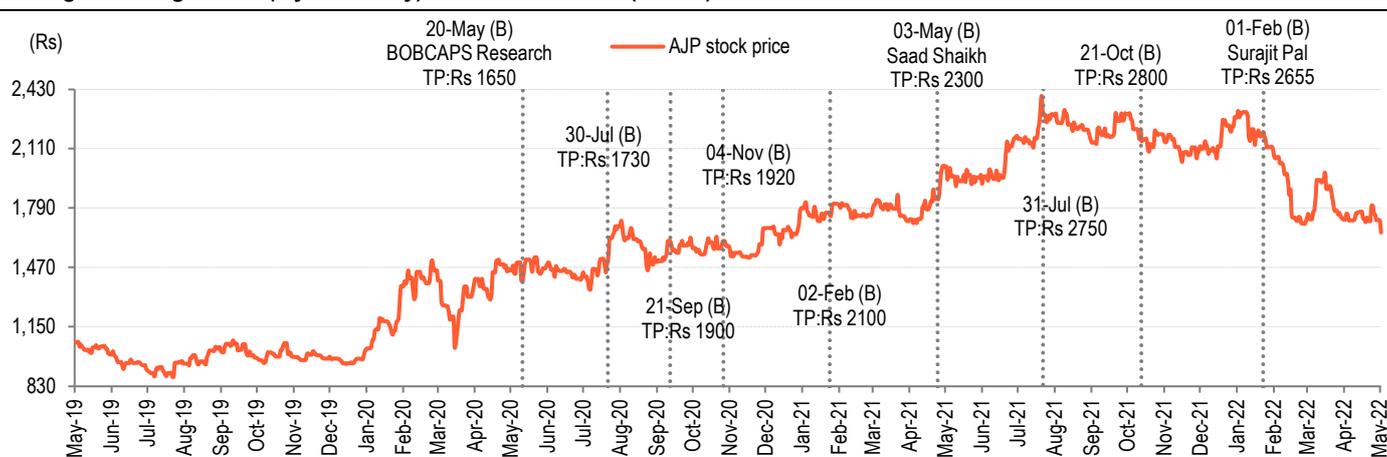
**HOLD** – Expected return from -6% to +15%

**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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