

BUY

TP: Rs 500 | ▲ 27%

AUROBINDO PHARMA

Pharmaceuticals

02 April 2020

Sandoz deal called off; upgrade to BUY

Aurobindo Pharma (ARBP) announced that the deal to buy Sandoz's US generic oral solids and dermatology business has been mutually called off. Management cited (1) delays in US FTC approval for the transaction, and (2) Covid-19-led macro challenges which could have prolonged integration synergies. To recap, in Sep'18, ARBP had entered a definitive agreement to acquire this business for US\$ 900mn, valued at ~1x CY18 sales. We cut FY21/FY22 EPS by 12%/4% but upgrade to BUY from ADD on easing leverage concerns and attractive valuations.

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Deal termination alleviates leverage concerns: The Sandoz deal was one of the key near-term stock triggers for ARBP and its termination impacts our FY21/ FY22 earnings, besides potentially raising growth concerns for the US business in the medium term. Importantly, on the positive side, we view this event as a sentiment-booster in current uncertain times as (1) ARBP's net debt/EBITDA should now hold at comfortable levels of 0.4x in FY21E vs. our post-deal estimate of 1.8x, and (2) FCF could surge over the next two years to Rs 42bn from negative Rs 25bn, driving greater balance sheet comfort and stronger ROIC.

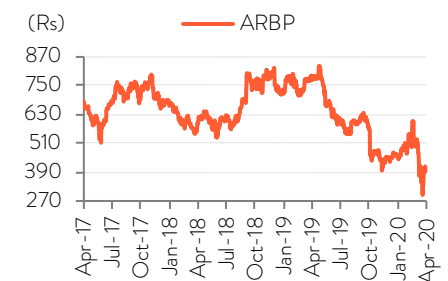
Management call takeaways: (1) Net debt-free status to be reached by FY22 – would repay Rs 10bn p.a. over two years. (2) Targeting US sales growth of 4-5% p.a., supported by >50 filings. (3) Inorganic assets not cheap at present and hence may be avoided. (4) Covid-19 lockdown has led to 20-25% lower utilisation across facilities.

Upgrade to BUY: Post the recent correction, the stock is trading at attractive valuations of 6x FY21E EV/EBITDA, 40%/25% below the 5Y/10Y mean, and 1.2x FY21E P/BV, close to historical lows. With comfort on leverage returning and resilient margins, risk of multiple downgrade subsides. We see 10% downside in the worst case (OAI at Unit-IV); upgrade to BUY, new TP Rs 500 (vs. Rs 560).

Ticker/Price	ARBP IN/Rs 392
Market cap	US\$ 3.1bn
Shares o/s	586mn
3M ADV	US\$ 33.3mn
52wk high/low	Rs 838/Rs 289
Promoter/FPI/DII	52%/19%/15%

Source: NSE

STOCK PERFORMANCE



KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	164,630	195,634	230,854	238,449	248,127
EBITDA (Rs mn)	37,718	39,519	47,118	46,663	48,548
Adj. net profit (Rs mn)	24,227	24,126	27,331	25,602	28,059
Adj. EPS (Rs)	41.3	41.2	46.6	43.7	47.9
Adj. EPS growth (%)	5.3	(0.4)	13.3	(6.3)	9.6
Adj. ROAE (%)	23.1	18.8	18.0	14.6	14.1
Adj. P/E (x)	9.5	9.5	8.4	9.0	8.2
EV/EBITDA (x)	7.0	6.6	5.8	5.9	5.4

Source: Company, BOBCAPS Research

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



Valuation methodology

Three sites will be critical to drive growth for ARBP in coming years, i.e. Units 4, 10 and Eugia. Together these account for ~75% of the company’s pending ANDAs. We assume a high probability of injectables Unit 4 being classified as OAI (official action indicated), given that the USFDA has highlighted multiple red flags in its 14 observations. This unit accounts for 30% of ARBP’s pending ANDAs. Moreover, Unit 10 and Eugia (together 62 pending ANDAs accounting for 40% of pending files) will be due for inspection in the next 3-4 months.

ARBP’s stock price has corrected over 25% in the last one month owing to high leverage concerns amidst growing Covid-19-led macro challenges. At current valuations of ~6x FY21E EV/EBITDA, ARBP is now trading 10% below global peers Teva, Endo and Perrigo, and 40%/25% below its 5/10-year mean. It is also close to historical P/BV lows at 1.2x on FY21E.

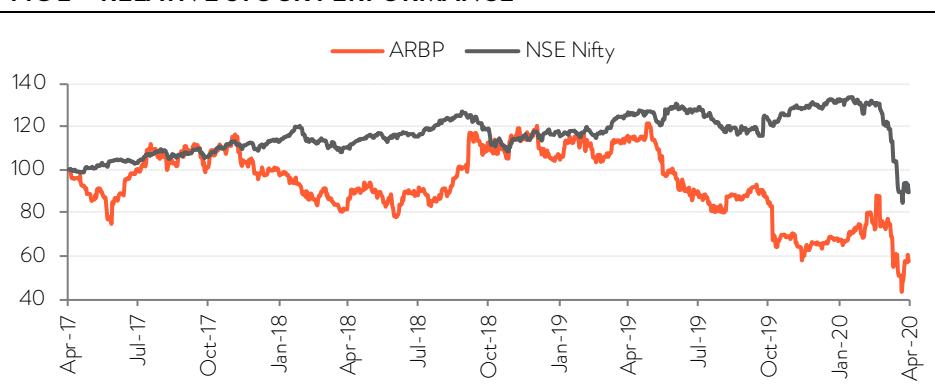
We upgrade the stock from ADD to BUY given easing leverage concerns post-Sandoz deal termination and attractive valuations. We have a revised Mar’21 target price of Rs 500 (Rs 560 earlier), based on 6.5x FY22E EV/EBITDA, as we cut FY21/FY22 EPS estimates by 12%/4% to strip away the estimated upside from Sandoz. Key downside risks include penalty risk from the Aceto supply-chain sabotage claim (in District Court).

FIG 1 – REVISED ESTIMATES

(Rs bn)	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Sales	230.9	238.4	248.1	230.9	285.8	293.0	0.0	(16.6)	(15.3)
EBITDA	47.1	46.7	48.5	47.1	55.5	57.1	0.0	(15.9)	(15.0)
EBITDA margin (%)	20.4	19.6	19.6	20.4	19.4	19.5	0bps	15bps	7bps
EPS (Rs)	46.6	43.7	47.9	46.6	49.4	50.0	0.0	(11.5)	(4.2)

Source: Company, BOBCAPS Research

FIG 2 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **US approval delays:** The US forms the single largest delta in our operating profit estimates for FY21-FY22 (>60% of profit); hence, delays in key approvals and execution hurdles are key risk factors.
- **Regulatory risk:** ARBP supplies to the US from multiple plants. Its key facilities are Unit 3, Unit 7, Unit 10, Eugia and Unit 4. Any adverse action by the USFDA at these facilities can impact our EPS estimates.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	164,630	195,634	230,854	238,449	248,127
EBITDA	37,718	39,519	47,118	46,663	48,548
Depreciation	5,580	6,679	9,667	11,005	11,478
EBIT	32,138	32,839	37,451	35,658	37,070
Net interest income/(expenses)	(777)	(2,626)	(1,915)	(2,320)	(2,088)
Other income/(expenses)	1,020	1,157	905	1,495	1,841
Exceptional items	0	0	0	0	0
EBT	32,381	31,370	36,441	34,833	36,823
Income taxes	8,183	7,268	9,110	9,231	8,764
Extraordinary items	0	(483)	0	0	0
Min. int./Inc. from associates	(29)	(25)	0	0	0
Reported net profit	24,227	23,642	27,331	25,602	28,059
Adjustments	0	483	0	0	0
Adjusted net profit	24,227	24,126	27,331	25,602	28,059

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	26,274	26,771	37,949	39,197	40,788
Other current liabilities	15,324	24,390	20,777	21,460	22,331
Provisions	2,567	2,273	2,682	2,770	2,883
Debt funds	47,710	69,668	58,000	58,000	46,400
Other liabilities	0	0	0	0	0
Equity capital	586	586	586	586	586
Reserves & surplus	117,001	138,686	163,072	185,744	210,873
Shareholders' fund	117,587	139,272	163,657	186,330	211,459
Total liabilities and equities	209,462	262,374	283,065	307,758	323,862
Cash and cash eq.	12,616	19,594	16,601	33,246	40,388
Accounts receivables	38,788	47,771	56,923	65,328	67,980
Inventories	58,584	72,456	75,897	71,861	74,778
Other current assets	15,324	17,518	20,777	21,460	22,331
Investments	3,115	3,602	3,602	3,602	3,602
Net fixed assets	47,365	56,937	64,770	67,764	70,286
CWIP	15,829	16,685	16,685	16,685	16,685
Intangible assets	17,841	27,811	27,811	27,811	27,811
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	209,462	262,373	283,065	307,758	323,862

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	29,807	30,322	36,998	36,608	39,537
Interest expenses	777	2,626	1,915	2,320	2,088
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(12,847)	(15,780)	(7,878)	(3,033)	(3,865)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	17,737	17,168	31,034	35,895	37,760
Capital expenditures	(22,593)	(26,028)	(17,500)	(14,000)	(14,000)
Change in investments	(657)	(487)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(23,250)	(26,515)	(17,500)	(14,000)	(14,000)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	14,069	21,958	(11,668)	0	(11,600)
Interest expenses	(777)	(2,626)	(1,915)	(2,320)	(2,088)
Dividends paid	(2,641)	(2,930)	(2,930)	(2,930)	(2,930)
Other financing cash flows	2,344	(77)	(16)	0	0
Cash flow from financing	12,995	16,325	(16,528)	(5,250)	(16,617)
Changes in cash and cash eq.	7,482	6,978	(2,994)	16,645	7,142
Closing cash and cash eq.	12,616	19,594	16,600	33,246	40,388

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	41.3	40.4	46.6	43.7	47.9
Adjusted EPS	41.3	41.2	46.6	43.7	47.9
Dividend per share	2.5	2.5	2.5	2.5	2.5
Book value per share	200.9	238.0	279.7	318.4	361.3

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	1.6	1.3	1.2	1.2	1.1
EV/EBITDA	7.0	6.6	5.8	5.9	5.4
Adjusted P/E	9.5	9.5	8.4	9.0	8.2
P/BV	2.0	1.6	1.4	1.2	1.1

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	74.8	76.9	75.0	73.5	76.2
Interest burden (PBT/EBIT)	100.8	95.5	97.3	97.7	99.3
EBIT margin (EBIT/Revenue)	19.5	16.8	16.2	15.0	14.9
Asset turnover (Revenue/Avg TA)	28.2	26.1	26.8	25.6	24.7
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.4	1.3	1.3
Adjusted ROAE	23.1	18.8	18.0	14.6	14.1

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	10.4	18.8	18.0	3.3	4.1
EBITDA	9.8	4.8	19.2	(1.0)	4.0
Adjusted EPS	5.3	(0.4)	13.3	(6.3)	9.6
Profitability & Return ratios (%)					
EBITDA margin	22.9	20.2	20.4	19.6	19.6
EBIT margin	19.5	16.8	16.2	15.0	14.9
Adjusted profit margin	14.7	12.3	11.8	10.7	11.3
Adjusted ROAE	23.1	18.8	18.0	14.6	14.1
ROCE	22.8	18.2	17.8	15.9	15.5
Working capital days (days)					
Receivables	86	89	90	100	100
Inventory	130	135	120	110	110
Payables	58	50	60	60	60
Ratios (x)					
Gross asset turnover	2.1	1.9	1.9	1.7	1.6
Current ratio	2.8	2.9	2.8	3.0	3.1
Net interest coverage ratio	41.4	12.5	19.6	15.4	17.8
Adjusted debt/equity	0.3	0.4	0.3	0.1	0.0

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

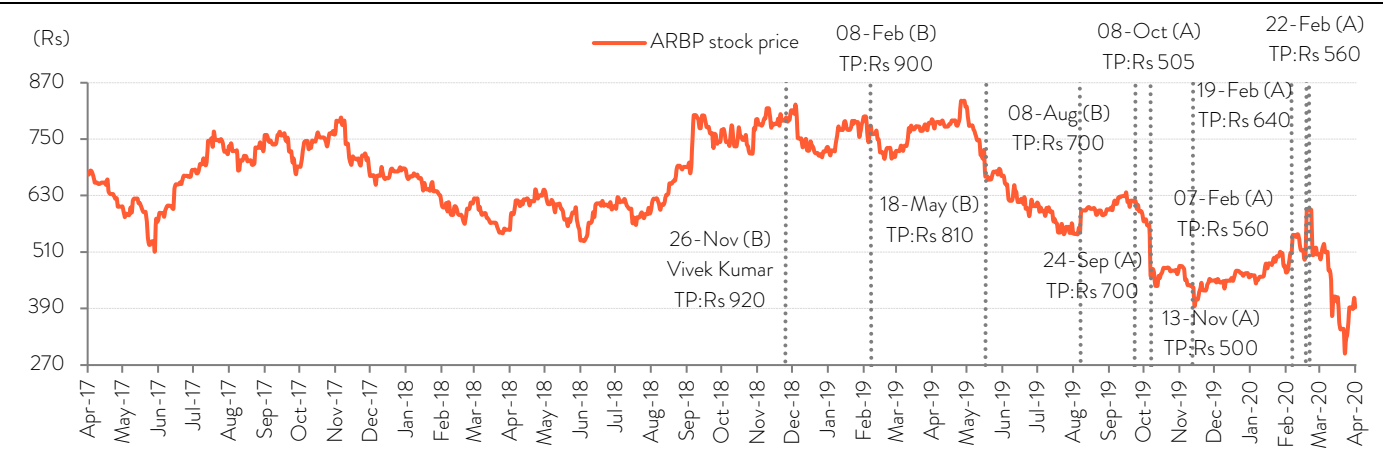
ADD – Expected return from >+5% to +15%

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: AUROBINDO PHARMA (ARBP IN)



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

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