ADD
TP: Rs 560 | ⮟ 7%

AUROBINDO PHARMA | Pharmaceuticals | 22 February 2020

USFDA error on Unit IV to erase recent stock gains

USFDA inspection at Unit IV remains open: Aurobindo Pharma (ARBP) has received further communication from the USFDA on its Unit IV injectable plant stating that the inspection is still open and under review. The letter issued on 19 February mentions that the establishment inspection report (EIR) with voluntary action indicated (VAI) classification for the facility was erroneously sent to the company and is being retracted. To recap, this plant was last inspected in Nov'19 wherein the FDA had issued 14 observations, some critical in our view.

Management call takeaways: Our interaction with ARBP's management indicates that the earlier FDA's communication on VAI was intended for an inspection for another facility, possibly Unit VIII – an API plant that was issued four Form 483 observations during the Oct'19 inspection.

Implication: News of the Unit IV EIR retraction will likely erase the positive investor sentiment that saw the stock gain ~20% on 19 February, sparked by hopes of a possible rerating (see our 19 Feb report: **EIR received for Unit IV – a key sentiment booster**). We note that while the exchange notification and our management interactions (on FDA document content received) clearly point to a slipup on the part of the USFDA, this rare misstep by the regulators is unlikely to shake investors' faith in the future EIR communications to companies.

We revert to original 7x multiple and TP of Rs 560: We return to our earlier target multiple of 7x on FY22E EV/EBITDA (from 8x), well below the stock's five-year mean of 9x as downside risks to our FY21/FY22 EPS estimates from unit IV review persist. Global peers such as Teva, Endo and Perrigo are trading at ~7x. Our multiple for ARBP assumes high risk of an official action indicated (OAI) classification for unit IV, which is a key growth driver accounting for 30% of the company's pending ANDA filings. We retain ADD on ARBP and revert to our Mar'21 TP of Rs 560 (from Rs 640).

Near-term events to watch: The USFDA will start inspections at Unit 10 (oral solids) from 24 February and at the Eugia oncology unit sometime in April. Together both house 62 pending ANDAs, accounting for 40% of pending approvals. These units will be key growth drivers over the next 2-3 years. Sandoz regulatory approval is another key monitorable.

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Ticker/Price	ARBP IN/Rs 600
Market cap	US$ 4.9bn
Shares o/s	586mn
3M ADV	US$ 28.6mn
52wk high/low	Rs 838/Rs 389
Promoter/FPI/DII	52%/19%/15%

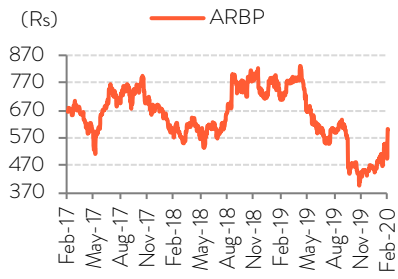
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY20E	FY21E	FY22E
Total revenue (Rs mn)	230,854	285,827	292,957
EBITDA (Rs mn)	47,118	55,500	57,116
Adj. net profit (Rs mn)	27,331	28,939	29,294
Adj. EPS (Rs)	46.6	49.4	50.0
Adj. EPS growth (%)	13.3	5.9	1.2
Adj. ROAE (%)	18.0	16.4	14.4
Adj. P/E (x)	12.9	12.1	12.0
EV/EBITDA (x)	8.4	7.2	7.4

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

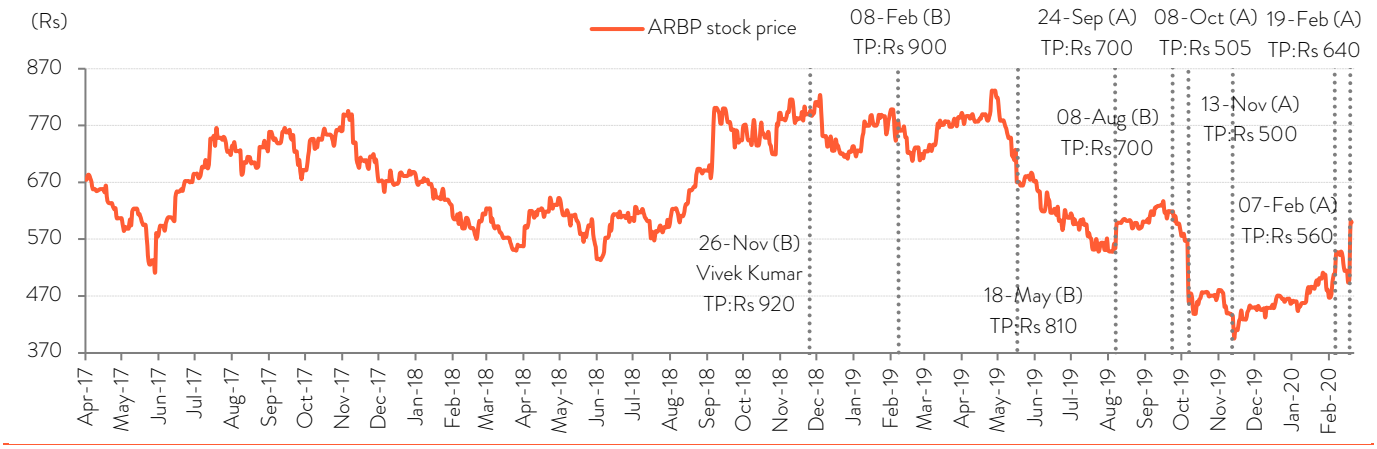
ADD – Expected return from >+5% to +15%

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: AURBINDO PHARMA (ARBP IN)



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

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