

**BUY**

TP: Rs 700 | ▲ 26%

**AUROBINDO PHARMA**

Pharmaceuticals

08 August 2019

## Good beat; progress on facility issues & Sandoz are key catalysts

**Q1FY20 revenue/EBITDA beat estimates by 8%/10% spurred by strong US sales at US\$ 384mn and 260bps gross margin expansion YoY and QoQ. Net debt has reduced by US\$ 131mn QoQ following a drop in working capital in the US.**

**Injectable sales were flat QoQ which should improve from Q3. Reinspection for three API units will take place post Dec'19 (CAPAs under implementation). We cut FY20/FY21 EPS by 2-3% to Rs 48/Rs 51, trim our EV/EBITDA multiple to 9x (vs. 10x) on FDA worries, and reset TP to Rs 700 (vs. Rs 810).**

Vivek Kumar

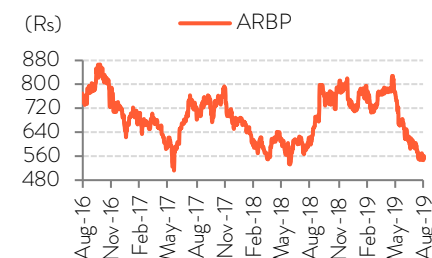
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**Strong gross margins backed by US sales:** Aurobindo Pharma (ARBP) reported strong US sales of US\$ 384mn, up 9% QoQ, led by higher volumes in OSDs and Valsartan. Spectrum contributed US\$ 25mn in Q1. Gross margins were strong, rising 260bps to 57.8% (vs. 55.5% in FY19) on higher US contribution. Injectable sales stayed flat QoQ at US\$ 67mn and management has guided for similar Q2 sales, but improvement in H2. Further, ARBP believes Eugia ramp-up and new approvals from Unit 4 should counter the generic impact in Ertapenem (another generic expected besides Apotex that launched in May'19).

Ticker/Price	ARBP IN/Rs 555
Market cap	US\$ 4.6bn
Shares o/s	586mn
3M ADV	US\$ 26.8mn
52wk high/low	Rs 838/Rs 537
Promoter/FPI/DII	52%/19%/15%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

**FDA worries could weigh on stock:** We lower our EV/EBITDA multiple to 9x from 10x earlier and EPS estimates by 2-3% for FY20/FY21 to account for potential disruption in US sales from facility resolution delays. This results in a revised TP of Rs 700 (Rs 810 earlier). We retain BUY on favourable risk-reward as the stock appears to be pricing in the worst of the facility risk and some part of Unit 3 escalation. Overall, we expect US sales (ex-Sandoz) to log an ~8% CAGR for FY19-FY21, with combined sales of US\$ 2.2bn in FY21.

**Near-term downside risks:** (1) adverse outcome of FDA inspection at formulation Unit 7 (10% of topline) and Unit 3, (2) Sandoz consolidation delays, (3) penalty risk from Aceto supply-chain sabotage claim (in District court).

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	24,227	24,126	28,087	29,815	30,290
Adj. EPS (Rs)	41.3	41.2	47.9	50.9	51.7
Adj. EPS growth (%)	5.3	(0.4)	16.4	6.2	1.6
Adj. ROAE (%)	23.1	18.8	18.5	16.8	14.8
Adj. P/E (x)	13.4	13.5	11.6	10.9	10.7
EV/EBITDA (x)	9.4	9.1	7.6	7.8	7.4

Source: Company, BOBCAPS Research

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**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)	Q1FY20E	Var (%)
<b>Net Sales</b>	<b>54,446</b>	<b>42,502</b>	<b>28.1</b>	<b>52,921</b>	<b>2.9</b>	<b>50,379</b>	<b>8.1</b>
<b>EBITDA</b>	<b>11,466</b>	<b>7,793</b>	<b>47.1</b>	<b>10,603</b>	<b>8.1</b>	<b>10,401</b>	<b>10.2</b>
Depreciation	2,408	1,545	-	1,866	-	1,763	-
<b>EBIT</b>	<b>9,058</b>	<b>6,248</b>	<b>45.0</b>	<b>8,737</b>	<b>3.7</b>	<b>8,638</b>	<b>-</b>
Interest	499	295	-	500	-	450	-
Other Income	110	437	-	323	-	325	-
<b>PBT</b>	<b>8,669</b>	<b>6,390</b>	<b>35.7</b>	<b>8,560</b>	<b>1.3</b>	<b>8,513</b>	<b>1.8</b>
Less: Taxation	2,277	1,155	-	2,311	-	2,128	-
Less: Minority Interest	0	4	-	0	-	0	-
<b>Recurring PAT</b>	<b>6,392</b>	<b>5,231</b>	<b>22.2</b>	<b>6,249</b>	<b>2.3</b>	<b>6,384</b>	<b>0.1</b>
Exceptional items	(126)	(681)	-	(384)	-	0	-
<b>Reported PAT</b>	<b>6,265</b>	<b>4,550</b>	<b>37.7</b>	<b>5,865</b>	<b>6.8</b>	<b>6,384</b>	<b>(1.9)</b>
<b>Key Ratios (%)</b>							
Gross Margin	57.8	55.1	-	55.2	-	55.5	-
EBITDA Margin	21.1	18.3	-	20.0	-	20.6	-
Tax / PBT	26.3	18.1	-	27.0	-	25.0	-
NPM	11.7	12.3	-	11.8	-	12.7	-
<b>EPS (Rs)</b>	<b>10.9</b>	<b>8.9</b>	<b>-</b>	<b>10.7</b>	<b>-</b>	<b>10.9</b>	<b>-</b>

Source: Company, BOBCAPS Research

**FIG 2 – REVENUE MIX**

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)	Q1FY20E	Var (%)
<b>Formulations</b>	<b>47,119</b>	<b>35,008</b>	<b>34.6</b>	<b>43,734</b>	<b>7.7</b>	<b>42,726</b>	<b>10.3</b>
US	26,884	18,896	42.3	24,810	8.4	24,360	10.4
Europe	13,916	11,991	16.1	13,118	6.1	13,991	(0.5)
EM	3,134	2,565	22.2	2,891	8.4	2,616	19.8
ARV	3,185	1,556	104.7	2,915	9.3	1,758	81.1
APIs	7,322	7,480	(2.1)	9,167	(20.1)	7,653	(4.3)
<b>Net Sales</b>	<b>54,445</b>	<b>42,503</b>	<b>28.1</b>	<b>52,921</b>	<b>2.9</b>	<b>50,379</b>	<b>8.1</b>

Source: Company, BOBCAPS Research

## Valuation methodology

We lower our target EV/EBITDA multiple for ARBP from 10x to 9x and prune FY20/FY21 EPS estimates by 2-3% to Rs 48/Rs 51 to account for potential disruption in US sales from (1) resolution delays at Units 1, 9 and 11, and (2) slower-than-expected Sandoz integration. On rolling valuations forward, we we reset Sep '20 target price of Rs 700 (Rs 810 earlier). Our implied P/E works out to 13.5x (vs. 16x earlier).

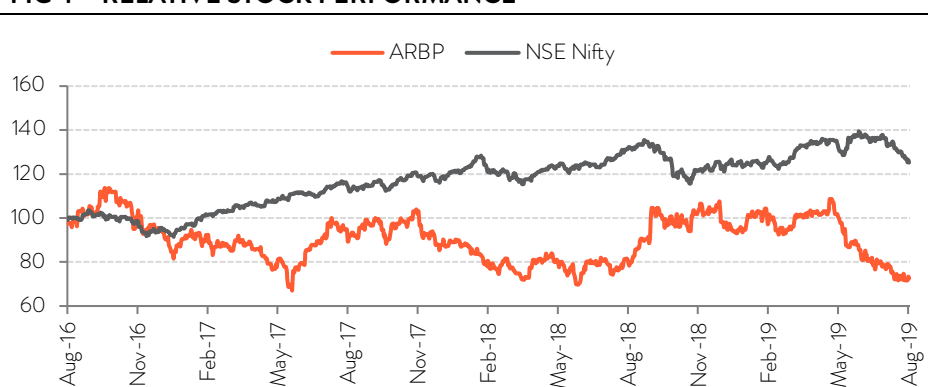
We retain BUY on favourable risk-reward as the stock appears to be pricing in the worst of the facility risk and some part of Unit 3 escalation. As per management, the company has worked meticulously to resolve two of the critical observations for Unit 3. Overall, we expect US sales (ex-Sandoz) to log an ~8% CAGR for FY19-FY21, with combined sales of US\$ 2.2bn in FY21. We retain our ex-Sandoz EBITDA growth estimate of 6% CAGR for FY19-FY21.

**FIG 3 – REVISED ESTIMATES**

(Rs bn)	New		Old		Change (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Sales	244	279	248	278	(1.3)	0.5
EBITDA	49	55	50	56	(0.7)	(1.3)
EBITDA margin (%)	20.2	19.8	20.1	20.2	12bps	(38bps)
EPS (Rs)	48	51	48.9	52.3	(1.9)	(2.6)

Source: Company, BOBCAPS Research

**FIG 4 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

- US approval delays and Sandoz execution:** The US forms the single largest delta in our operating profit estimates for FY19-FY21 (80% of incremental profit); hence, delays in key approvals and execution hurdles in the Sandoz acquisition are key risk factors.

- **Regulatory risk:** ARBP supplies to the US from multiple plants. The key oral facilities are Unit 3 and Unit 7, and the key injectable plant is Unit 4. While the FDA inspection at Unit 4 was completed in Dec'18 (EIR received), the other units are due for inspection in the next six months. We note that ARBP has now started most of the oral filings from the new Unit 10. Escalation of OAI (official action indicated) observations on two units (API units 1 & 9) and the warning letter received for intermediate Unit 11 are key risks to estimates.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Total revenue</b>	<b>164,630</b>	<b>195,634</b>	<b>244,436</b>	<b>279,019</b>	<b>287,572</b>
EBITDA	37,718	39,519	49,357	55,258	56,355
EBIT	32,138	32,839	39,153	42,275	42,392
Net interest income/(expenses)	(777)	(2,626)	(2,878)	(3,299)	(2,566)
Other income/(expenses)	1,020	1,157	1,174	777	560
Exceptional items	0	0	0	0	0
EBT	32,381	31,370	37,449	39,754	40,386
Income taxes	8,183	7,268	9,362	9,938	10,097
Extraordinary items	0	(483)	0	0	0
Min. int./Inc. from associates	(29)	(25)	0	0	0
<b>Reported net profit</b>	<b>24,227</b>	<b>23,642</b>	<b>28,087</b>	<b>29,815</b>	<b>30,290</b>
Adjustments	0	483	0	0	0
<b>Adjusted net profit</b>	<b>24,227</b>	<b>24,126</b>	<b>28,087</b>	<b>29,815</b>	<b>30,290</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	26,274	26,771	40,181	45,866	47,272
Other current liabilities	15,324	24,390	21,999	25,112	25,881
Provisions	2,567	2,273	2,840	3,242	3,341
Debt funds	47,710	69,668	122,168	97,734	73,301
Other liabilities	0	0	0	0	0
Equity capital	586	586	586	586	586
Reserves & surplus	117,001	138,686	163,827	190,713	218,073
Shareholders' fund	117,587	139,272	164,413	191,299	218,659
<b>Total liabilities and equities</b>	<b>209,462</b>	<b>262,373</b>	<b>351,601</b>	<b>363,253</b>	<b>368,454</b>
Cash and cash eq.	12,616	19,594	13,941	8,263	7,737
Accounts receivables	38,788	47,771	66,969	76,444	78,787
Inventories	58,584	72,456	80,363	84,088	86,665
Other current assets	15,324	17,518	21,999	25,112	25,881
Investments	3,115	3,602	3,602	3,602	3,602
Net fixed assets	47,365	56,936	120,232	121,249	121,286
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
<b>Total assets</b>	<b>209,462</b>	<b>262,373</b>	<b>351,601</b>	<b>363,253</b>	<b>368,454</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	29,807	30,322	38,291	42,799	44,253
Interest expenses	777	2,626	2,878	3,299	2,566
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(12,847)	(15,780)	(19,999)	(7,113)	(3,416)
Other operating cash flows	0	0	0	0	0
<b>Cash flow from operations</b>	<b>17,737</b>	<b>17,168</b>	<b>21,169</b>	<b>38,984</b>	<b>43,403</b>
Capital expenditures	(22,593)	(26,028)	(73,500)	(14,000)	(14,000)
Change in investments	(657)	(487)	0	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(23,250)</b>	<b>(26,515)</b>	<b>(73,500)</b>	<b>(14,000)</b>	<b>(14,000)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	14,069	21,958	52,500	(24,434)	(24,434)
Interest expenses	(777)	(2,626)	(2,878)	(3,299)	(2,566)
Dividends paid	(2,641)	(2,930)	(2,930)	(2,930)	(2,930)
Other financing cash flows	2,344	(77)	(16)	0	0
<b>Cash flow from financing</b>	<b>12,995</b>	<b>16,325</b>	<b>46,677</b>	<b>(30,662)</b>	<b>(29,929)</b>
<b>Changes in cash and cash eq.</b>	<b>7,482</b>	<b>6,978</b>	<b>(5,654)</b>	<b>(5,678)</b>	<b>(526)</b>
<b>Closing cash and cash eq.</b>	<b>12,616</b>	<b>19,594</b>	<b>13,940</b>	<b>8,263</b>	<b>7,737</b>

**Per Share**

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	41.3	40.4	47.9	50.9	51.7
Adjusted EPS	41.3	41.2	47.9	50.9	51.7
Dividend per share	2.5	2.5	2.5	2.5	2.5
Book value per share	200.9	238.0	281.0	326.9	373.6

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.1	1.8	1.5	1.6	1.4
EV/EBITDA	9.4	9.1	7.6	7.8	7.4
Adjusted P/E	13.4	13.5	11.6	10.9	10.7
P/BV	2.8	2.3	2.0	1.7	1.5

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	74.8	76.9	75.0	75.0	75.0
Interest burden (PBT/EBIT)	100.8	95.5	95.6	94.0	95.3
EBIT margin (EBIT/Revenue)	19.5	16.8	16.0	15.2	14.7
Asset turnover (Revenue/Avg TA)	28.2	26.1	24.7	24.2	24.7
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.6	1.6	1.4
Adjusted ROAE	23.1	18.8	18.5	16.8	14.8

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

**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	10.4	18.8	24.9	14.1	3.1
EBITDA	9.8	4.8	24.9	12.0	2.0
Adjusted EPS	5.3	(0.4)	16.4	6.2	1.6
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	22.9	20.2	20.2	19.8	19.6
EBIT margin	19.5	16.8	16.0	15.2	14.7
Adjusted profit margin	14.7	12.3	11.5	10.7	10.5
Adjusted ROAE	23.1	18.8	18.5	16.8	14.8
ROCE	22.8	18.2	16.3	15.0	14.8
<b>Working capital days (days)</b>					
Receivables	86	89	100	100	100
Inventory	130	135	120	110	110
Payables	58	50	60	60	60
<b>Ratios (x)</b>					
Gross asset turnover	2.1	1.9	1.4	1.4	1.4
Current ratio	2.8	2.9	2.8	2.6	2.6
Net interest coverage ratio	41.4	12.5	13.6	12.8	16.5
Adjusted debt/equity	0.3	0.4	0.7	0.5	0.3

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

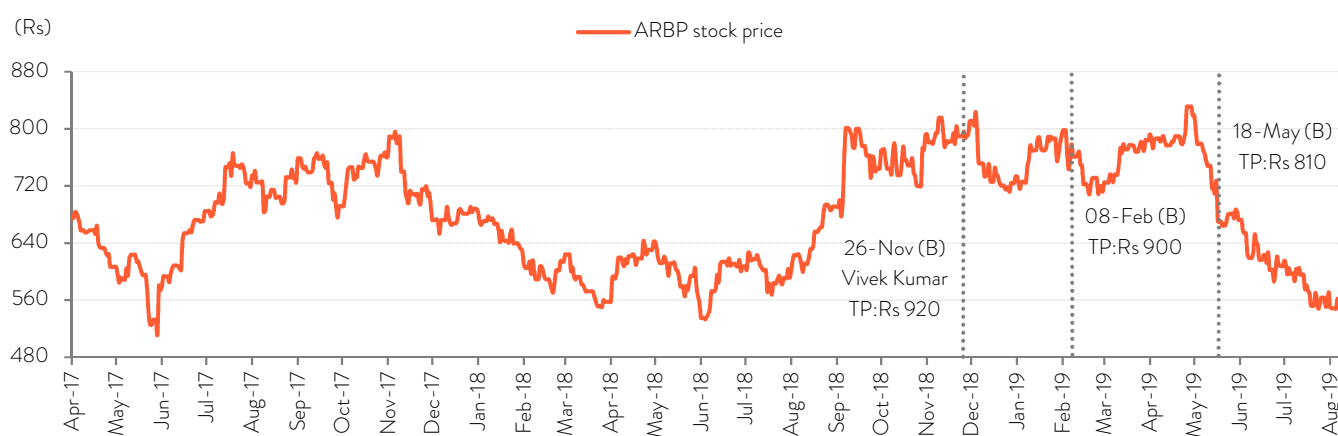
**ADD** – Expected return from >+5% to +15%

**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: AUROBINDO PHARMA (ARBP IN)



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

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