

BUY

TP: Rs 1,000 | ▲ 13%

AUROBINDO PHARMA

Pharmaceuticals

13 August 2020

In-line Q1; earnings, balance sheet comfort merit higher multiple

Q1 revenue/EBITDA were in line backed by strong US sales and sustained gross margins. Working capital efficiency led to a large US\$ 168mn QoQ net debt decline. Injectable sales fell QoQ but expect full normalisation in 6-9 months. Management expects to sustain US momentum on healthy pipeline visibility. New injectable unit commissioning, Unit-7 FDA inspection and depo-injection filings are key near-term events in FY21. We raise FY21/FY22 EPS by 5%. Retain BUY and roll to a Sep'21 TP of Rs 1,000 (vs. Rs 900), set at 11x EV/EBITDA.

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US sales and net debt reduction – positive surprises: US sales at US\$ 414mn (flat QoQ) were a good beat, led by Natrol (\$51mn, +40% QoQ) which offset a decline in injectables (\$51mn, -15% on subdued recovery in hospital segment) and orals (\$277mn, -1%). EU and EM sales declined 20-23% QoQ due to the Q4 pre-buying effect. EBITDA margin at 21.2% and gross margin at 59.4% were stable QoQ. Sequential recovery in US injectables, 50 launches for the rest of FY21 (6 in Q1), and new injectables unit commissioning in Q4 are expected to drive >6% US sales growth for FY20-FY22. Net debt reduced on improved US collections; going ahead, the extent of reduction may not be the same.

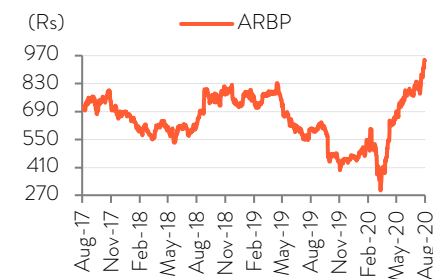
Earnings takeaways: (1) Other expense included Rs 600mn one-time cost on R&D assets. (2) API (non-antibiotics) benefitted from China supply disruption. (3) TLD migration supporting ARV sales. (4) EU margins touching double digits. (5) Unit 7 CAPA submitted; desktop reviews awaited for Units 1, 9, 11.

Strong US execution to support higher valuation: The stock trades at 10x FY22E EBITDA (7Y band: 5-15x), 30% above global peers. Strong US pipeline execution, nimble supply chain and balance sheet comfort can drive upsides to our EPS and FCF, supporting a higher multiple in the next 18 months. Expect near-term consolidation in view of the ~75% stock rally in the last four months.

Ticker/Price	ARBP IN/Rs 881
Market cap	US\$ 6.9bn
Shares o/s	586mn
3M ADV	US\$ 52.3mn
52wk high/low	Rs 968/Rs 289
Promoter/FPI/DII	52%/19%/15%

Source: NSE

STOCK PERFORMANCE



KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	195,634	230,986	245,602	261,144	276,861
EBITDA (Rs mn)	39,519	48,640	51,154	54,314	57,651
Adj. net profit (Rs mn)	24,126	28,911	31,415	32,638	34,973
Adj. EPS (Rs)	41.2	49.3	53.6	55.7	59.7
Adj. EPS growth (%)	(0.4)	19.8	8.7	3.9	7.2
Adj. ROAE (%)	18.8	18.7	17.1	15.3	14.4
Adj. P/E (x)	21.4	17.9	16.4	15.8	14.8
EV/EBITDA (x)	13.9	11.5	10.9	9.9	9.0

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)	Q1FY21E	Var (%)	FY20	FY19	YoY (%)
Net Sales	59,248	54,446	8.8	61,584	(3.8)	59,659	(0.7)	230,984	195,634	18.1
EBITDA	12,573	11,466	9.7	13,425	(6.3)	12,682	(0.9)	48,645	39,522	23.1
Depreciation	2,555	2,408	-	2,324	-	2,750	-	9,666	6,678	-
EBIT	10,018	9,058	10.6	11,101	(9.8)	9,932	-	38,979	32,844	18.7
Interest	211	499	-	318	-	380	-	1,597	1,625	-
Other Income	934	110	-	326	-	300	-	862	1,157	-
PBT	10,741	8,669	23.9	11,109	(3.3)	9,852	9.0	38,244	32,376	18.1
Less: Taxation	3,038	2,277	-	2,285	-	2,463	-	9,134	7,267	-
Less: Minority Interest	120	0	-	193	-	0	-	193	(22)	-
Recurring PAT	7,584	6,392	18.6	8,631	(12.1)	7,389	2.6	28,917	25,131	15.1
Exceptional items	222	(126)	-	(140)	-	0	-	(705)	(1,483)	-
Reported PAT	7,806	6,265	24.6	8,491	(8.1)	7,389	5.6	28,212	23,647	19.3
Key Ratios (%)										
Gross Margin	59.4	57.8	-	59.4	-	58.8	-	57.9	55.5	-
EBITDA Margin	21.2	21.1	-	21.8	-	21.3	-	21.1	20.2	-
Tax / PBT	28.3	26.3	-	20.6	-	25.0	-	23.9	22.4	-
NPM	12.8	11.7	-	14.0	-	12.4	-	12.5	12.8	-
EPS (Rs)	12.9	10.9	-	14.7	-	12.6	-	49.4	42.9	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)	Q1FY21E	Var (%)	FY20	FY19	YoY (%)
Formulations	51,444	47,119	9.2	54,012	(4.8)	52,057	(1.2)	200,120	161,568	23.9
US	31,071	26,884	15.6	29,903	3.9	29,230	6.3	114,836	90,306	27.2
Europe	13,222	13,916	(5.0)	16,525	(20.0)	15,590	(15.2)	59,217	49,602	19.4
EM	2,896	3,134	(7.6)	3,766	(23.1)	3,766	(23.1)	13,551	11,936	13.5
ARV	4,255	3,185	33.6	3,818	11.4	3,471	22.6	12,516	9,724	28.7
APIs	7,801	7,322	6.5	7,556	3.2	7,598	2.7	30,834	34,031	(9.4)
Net Sales	59,248	54,445	8.8	61,585	(3.8)	59,659	(0.7)	230,954	195,599	18.1

Source: Company, BOBCAPS Research

FIG 3 – US SALES SPLIT

(US\$ mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Oral solid	277	242	14.4	280	(1.0)
Generic Injectables	51	65	(22.0)	60	(15.3)
Natrol	51	38	33.8	37	40.1
Branded Injectables (Spectrum)	26	27	(4.5)	28	(8.8)
OTC	10	12	(17.3)	11	(12.1)
Total	414	384	7.9	415	(0.3)

Source: Company, BOBCAPS Research

Valuation methodology

Three sites will be critical to drive growth for Aurobindo Pharma (ARBP) in the coming years, i.e. Units 4, 10 and Eugia. Together these account for ~78% of the company's pending ANDAs. All of these units have cleared USFDA inspection recently. We assume a low probability of any significant impact from Aurolife unit OAI classification, given limited pending approvals (~5% of total pending ANDAs) and low contribution to US business (~2% of total sales).

We increase our FY21/FY22 EPS estimates by ~5% each driven by strong US sales, ~30bps higher margin assumptions and reduction in interest cost. The stock has moved up sharply by ~75% in the last four months and is now trading at 10x FY22E EBITDA (vs. the seven-year historical band of 5-15x), which is ~30% higher than global peers Teva, Endo, Mylan and Perrigo.

The rerating is in line with our expectations, as highlighted in our [Apr'20 report](#) and subsequent [June'20 note](#), considering favourable risk-reward, substantial reduction in leverage and resilient operating results. ARBP's filing momentum and growth outlook remain buoyant and we see further upside risk to our FY21/FY22 EPS estimates – this could fuel multiple expansion over the next 18 months.

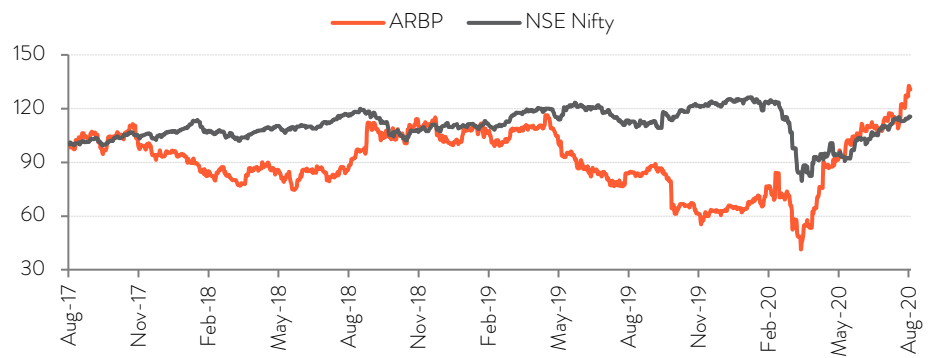
We retain BUY and roll over to a Sep'21 target price of Rs 1,000 (from Rs 900), based on ~11x EV/EBITDA vs. 10x earlier. The increase in target multiple reflects a continued 25-30% discount to other frontline stocks (Cipla, Dr Reddy's, Lupin) due to low branded sales and high US exposure. Penalty risk from the Aceto supply-chain sabotage claim (in the US District Court) is a key downside risk.

FIG 4 – REVISED ESTIMATES

(Rs bn)	New		Old		Change (%)	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Sales	246	261	248	258	(0.9)	1.1
EBITDA	51	54	51	53	0.5	2.4
EBITDA margin (%)	20.8	20.8	20.5	20.5	29bps	25bps
EPS (Rs)	53.6	55.7	51.1	53.2	4.8	4.7

Source: Company, BOBCAPS Research

FIG 5 – 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)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	195,634	230,986	245,602	261,144	276,861
EBITDA	39,519	48,640	51,154	54,314	57,651
Depreciation	6,680	9,667	10,358	11,478	12,598
EBIT	32,839	38,973	40,796	42,836	45,053
Net interest income/(expenses)	(2,626)	(1,597)	(967)	(836)	(334)
Other income/(expenses)	1,157	862	2,057	1,518	1,912
Exceptional items	0	0	0	0	0
EBT	31,370	38,238	41,886	43,517	46,630
Income taxes	7,268	9,134	10,472	10,879	11,658
Extraordinary items	(483)	(705)	0	0	0
Min. int./Inc. from associates	(25)	193	0	0	0
Reported net profit	23,643	28,206	31,415	32,638	34,973
Adjustments	483	705	0	0	0
Adjusted net profit	24,126	28,911	31,415	32,638	34,973

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	26,771	25,450	33,644	35,773	37,926
Other current liabilities	24,390	30,745	29,472	31,337	33,223
Provisions	2,273	4,914	5,225	5,555	5,889
Debt funds	69,668	56,867	39,807	15,923	6,369
Other liabilities	0	0	0	0	0
Equity capital	586	586	586	586	586
Reserves & surplus	138,686	168,912	197,396	227,104	259,148
Shareholders' fund	139,272	169,498	197,982	227,690	259,734
Total liabilities and equities	262,374	287,473	306,130	316,279	343,142
Cash and cash eq.	19,594	28,422	26,436	24,148	39,583
Accounts receivables	47,771	43,552	57,195	64,392	68,267
Inventories	72,456	76,999	77,382	78,701	83,438
Other current assets	17,518	19,130	22,104	23,503	24,917
Investments	3,602	5,547	5,547	5,547	5,547
Net fixed assets	56,937	64,948	68,590	71,112	72,514
CWIP	16,685	19,859	19,859	19,859	19,859
Intangible assets	27,811	29,017	29,017	29,017	29,017
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	262,373	287,474	306,130	316,279	343,142

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	30,322	37,873	41,773	44,116	47,571
Interest expenses	2,626	1,597	967	836	334
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(15,780)	5,738	(9,767)	(5,590)	(5,653)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	17,168	45,208	32,972	39,362	42,252
Capital expenditures	(26,028)	(17,500)	(14,000)	(14,000)	(14,000)
Change in investments	(487)	(1,945)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(26,515)	(19,445)	(14,000)	(14,000)	(14,000)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	21,958	(12,801)	(17,060)	(23,884)	(9,554)
Interest expenses	(2,626)	(1,597)	(967)	(836)	(334)
Dividends paid	(2,930)	(2,930)	(2,930)	(2,930)	(2,930)
Other financing cash flows	(77)	391	(1)	0	0
Cash flow from financing	16,325	(16,937)	(20,958)	(27,650)	(12,818)
Changes in cash and cash eq.	6,978	8,827	(1,985)	(2,288)	15,435
Closing cash and cash eq.	19,594	28,421	26,436	24,148	39,583

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	40.4	48.1	53.6	55.7	59.7
Adjusted EPS	41.2	49.3	53.6	55.7	59.7
Dividend per share	2.5	2.5	2.5	2.5	2.5
Book value per share	238.0	289.6	338.3	389.1	443.8

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	2.8	2.4	2.3	2.1	1.9
EV/EBITDA	13.9	11.5	10.9	9.9	9.0
Adjusted P/E	21.4	17.9	16.4	15.8	14.8
P/BV	3.7	3.0	2.6	2.3	2.0

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	76.9	75.6	75.0	75.0	75.0
Interest burden (PBT/EBIT)	95.5	98.1	102.7	101.6	103.5
EBIT margin (EBIT/Revenue)	16.8	16.9	16.6	16.4	16.3
Asset turnover (Revenue/Avg TA)	26.1	26.5	26.5	27.1	27.2
Leverage (Avg TA/Avg Equity)	1.5	1.4	1.3	1.1	1.0
Adjusted ROAE	18.8	18.7	17.1	15.3	14.4

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	18.8	18.1	6.3	6.3	6.0
EBITDA	4.8	23.1	5.2	6.2	6.1
Adjusted EPS	(0.4)	19.8	8.7	3.9	7.2
Profitability & Return ratios (%)					
EBITDA margin	20.2	21.1	20.8	20.8	20.8
EBIT margin	16.8	16.9	16.6	16.4	16.3
Adjusted profit margin	12.3	12.5	12.8	12.5	12.6
Adjusted ROAE	18.8	18.7	17.1	15.3	14.4
ROCE	18.2	18.3	18.5	18.4	18.4
Working capital days (days)					
Receivables	89	69	85	90	90
Inventory	135	122	115	110	110
Payables	50	40	50	50	50
Ratios (x)					
Gross asset turnover	1.9	1.9	1.8	1.7	1.7
Current ratio	2.9	2.8	2.7	2.6	2.8
Net interest coverage ratio	12.5	24.4	42.2	51.2	134.7
Adjusted debt/equity	0.4	0.2	0.1	0.0	(0.1)

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

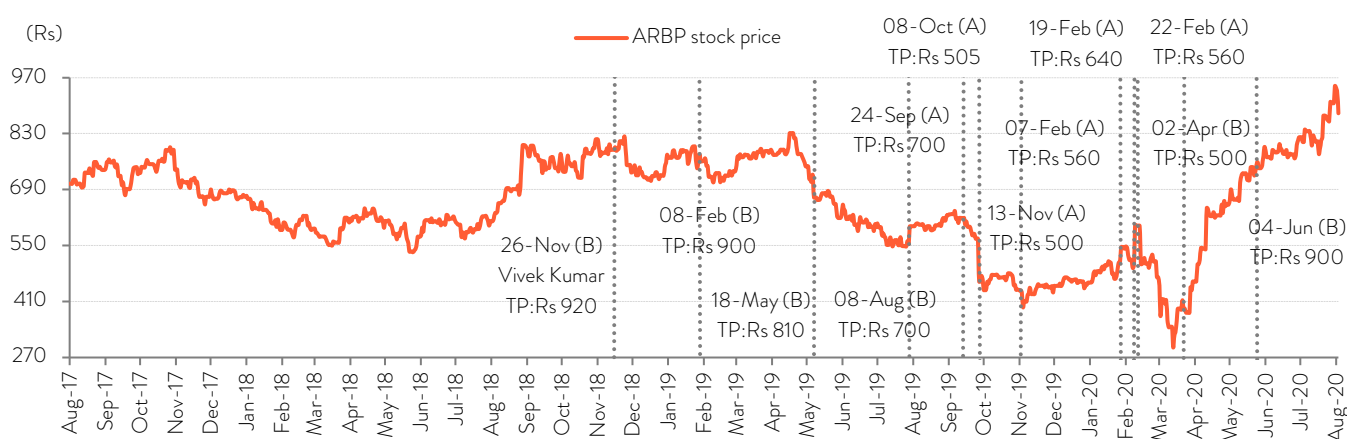
ADD – Expected return from >+5% to +15%

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: AUROBINDO PHARMA (ARBP IN)



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

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