

ADD

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AUROBINDO PHARMA

Pharmaceuticals

13 November 2019

Q2 beat; facility resolution, Sandoz key stock triggers

Sequential improvement in US sales to US\$ 405mn and stable gross margins led to a modest beat overall in Q2. The pickup in US business is broad-based. Injectable sales increased 12% QoQ and management expects the momentum to continue. Aurobindo (ARBP) clarified that the Sandoz FTC delay is not product-specific and expects to submit CAPAs to the FDA for Units 1, 9 and 11 by 15 Nov (reinspection likely in Mar'20). We believe FDA clearance on Units 7 and 4 (inspection ongoing) will be key near-term stock triggers. Retain ADD.

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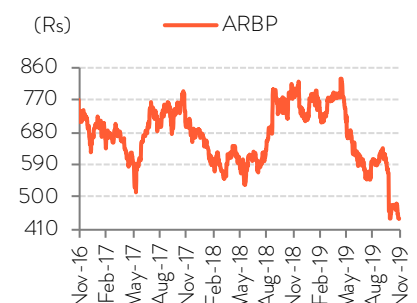
Steady gross margins to sustain; good US beat continues: ARBP saw best-ever US sales of US\$ 405mn in Q2 (+6% QoQ), led by good volume growth in the base portfolio and Eugia ramp-up. Management confirmed that all types of sartans have been discontinued except for Losartan. Valsartan has been re-filed under the CB-30 route and approval is expected in the near term. Spectrum's annualised sales of US\$ 100mn are tracking above estimates. Injectable sales rose 12% QoQ to US\$ 75mn; management expects the Q2 run-rate to sustain in H2. Gross margins were steady QoQ at 57.7% on a higher US mix. ARBP aims to be debt-free on the existing business (ex-Sandoz) in next 3 years.

Ticker/Price	ARBP IN/Rs 438
Market cap	US\$ 3.6bn
Shares o/s	586mn
3M ADV	US\$ 26.5mn
52wk high/low	Rs 838/Rs 431
Promoter/FPI/DII	52%/19%/15%

Source: NSE

Clearance on Units 7 & 4 key to stock: While an outcome of the ongoing FDA inspection at Unit 4 (injectable unit & ~5% of FY21E sales) is awaited, the risk-reward looks reasonable with the stock trading at 9.3x FY21E EPS (40% disc. to peers). Expect another 5% downside in the worst case (warning letter for Unit 7).

STOCK PERFORMANCE



Downside risks: Escalation of Unit 7 observations (10% of topline), adverse outcome on Unit 4 inspection, Sandoz consolidation delays, and penalty risk from Aceto supply sabotage claim.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	164,630	195,634	224,492	279,710	286,632
EBITDA (Rs mn)	37,718	39,519	46,597	53,325	54,858
Adj. net profit (Rs mn)	24,227	24,126	26,953	27,511	27,809
Adj. EPS (Rs)	41.3	41.2	46.0	47.0	47.5
Adj. EPS growth (%)	5.3	(0.4)	11.7	2.1	1.1
Adj. ROAE (%)	23.1	18.8	17.8	15.7	13.9
Adj. P/E (x)	10.6	10.6	9.5	9.3	9.2
EV/EBITDA (x)	7.6	7.4	6.6	5.7	6.5

Source: Company, BOBCAPS Research

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



FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	Q2FY20E	Var (%)
Net Sales	56,005	47,514	17.9	54,446	2.9	54,409	2.9
EBITDA	11,675	10,261	13.8	11,466	1.8	11,434	2.1
Depreciation	2,433	1,636	-	2,408	-	2,325	-
EBIT	9,242	8,625	7.1	9,058	2.0	9,109	-
Interest	409	354	-	499	-	600	-
Other Income	206	263	-	110	-	110	-
PBT	9,039	8,534	5.9	8,669	4.3	8,619	4.9
Less: Taxation	2,244	1,754	-	2,277	-	2,155	-
Less: Minority Interest	0	0	-	0	-	0	-
Recurring PAT	6,795	6,780	0.2	6,392	6.3	6,464	5.1
Exceptional items	(399)	(665)	-	(126)	-	0	-
Reported PAT	6,396	6,115	4.6	6,265	2.1	6,464	(1.1)
Key Ratios (%)							
Gross Margin	57.7	57.0	-	57.8	-	56.0	-
EBITDA Margin	20.8	21.6	-	21.1	-	21.0	-
Tax / PBT	24.8	20.6	-	26.3	-	25.0	-
NPM	12.1	14.3	-	11.7	-	11.9	-
EPS (Rs)	11.6	11.6	-	10.9	-	11.0	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	Q2FY20E	Var (%)
Formulations	47,939	39,348	21.8	47,119	1.7	46,059	4.1
US	28,355	22,268	27.3	26,884	5.5	26,600	6.6
Europe	14,013	11,565	21.2	13,916	0.7	13,565	3.3
EM	3,192	3,075	3.8	3,134	1.9	3,137	1.8
ARV	2,379	2,440	(2.5)	3,185	(25.3)	2,757	(13.7)
APIs	8,058	8,166	(1.3)	7,322	10.1	8,350	(3.5)
Net Sales	56,005	47,514	17.9	54,445	2.9	54,409	2.9

Source: Company, BOBCAPS Research

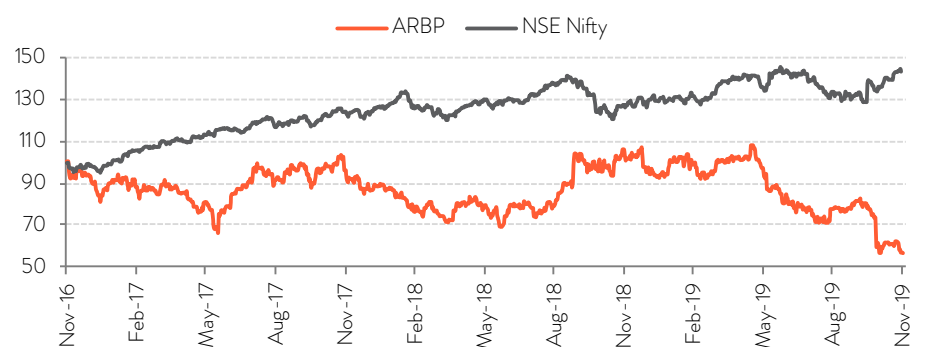
Valuation methodology

We note that 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. While Unit 10 and Eugia were inspected recently by the USFDA, the inspection for Unit 4 is in progress (outcome likely by next week).

We believe Unit 7 will remain an overhang on the stock in the near term until it receives an EIR from the USFDA or new approvals commence. We see another 5% downside risk to the stock in the event of a warning letter for the facility, but see a low probability of data integrity issues.

ARBP is trading at favourable valuations of ~9.3x FY21E EPS, a significant discount to peers (45-50% discount to Cipla, Sun, Lupin, Dr Reddy's and 35% discount to global peers Teva, Endo and Perrigo). We retain our FY21/FY22 EPS estimates and marginally revise our Sep'20 price target to Rs 500 (from Rs 505) based on ~7.0x EV/EBITDA). Key downside risks: (1) Sandoz consolidation delays, (2) penalty risk from Aceto supply-chain sabotage claim (in District court).

FIG 3 – 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 (75% 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 (inspection in progress). 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
Total revenue	164,630	195,634	224,492	279,710	286,632
EBITDA	37,718	39,519	46,597	53,325	54,858
Depreciation	5,580	6,679	9,667	13,683	15,486
EBIT	32,138	32,839	36,931	39,642	39,372
Net interest income/(expenses)	(777)	(2,626)	(2,090)	(3,837)	(4,398)
Other income/(expenses)	1,020	1,157	1,097	1,625	1,521
Exceptional items	0	0	0	0	0
EBT	32,381	31,370	35,938	37,430	36,495
Income taxes	8,183	7,268	8,984	9,919	8,686
Extraordinary items	0	(483)	0	0	0
Min. int./Inc. from associates	(29)	(25)	0	0	0
Reported net profit	24,227	23,642	26,953	27,511	27,809
Adjustments	0	483	0	0	0
Adjusted net profit	24,227	24,126	26,953	27,511	27,809

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	26,274	26,771	36,903	45,980	47,118
Other current liabilities	15,324	24,390	20,204	25,174	25,797
Provisions	2,567	2,273	2,608	3,250	3,330
Debt funds	47,710	69,668	69,668	122,168	97,734
Other liabilities	0	0	0	0	0
Equity capital	586	586	586	586	586
Reserves & surplus	117,001	138,686	162,694	187,275	212,155
Shareholders' fund	117,587	139,272	163,280	187,861	212,741
Total liabilities and equities	209,462	262,374	292,663	384,432	386,720
Cash and cash eq.	12,616	19,594	24,281	22,145	21,313
Accounts receivables	38,788	47,771	61,505	76,633	78,529
Inventories	58,584	72,456	73,806	84,296	86,382
Other current assets	15,324	17,518	20,204	25,174	25,797
Investments	3,115	3,602	3,602	3,602	3,602
Net fixed assets	47,365	56,937	64,770	128,087	126,601
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	292,663	384,432	386,720

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	29,807	30,322	36,620	41,194	43,295
Interest expenses	777	2,626	2,090	3,837	4,398
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(12,847)	(15,780)	(11,488)	(15,900)	(2,764)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	17,737	17,168	27,222	29,131	44,929
Capital expenditures	(22,593)	(26,028)	(17,500)	(77,000)	(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)	(77,000)	(14,000)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	14,069	21,958	0	52,500	(24,434)
Interest expenses	(777)	(2,626)	(2,090)	(3,837)	(4,398)
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	(5,035)	45,734	(31,761)
Changes in cash and cash eq.	7,482	6,978	4,686	(2,136)	(832)
Closing cash and cash eq.	12,616	19,594	24,280	22,145	21,313

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	41.3	40.4	46.0	47.0	47.5
Adjusted EPS	41.3	41.2	46.0	47.0	47.5
Dividend per share	2.5	2.5	2.5	2.5	2.5
Book value per share	200.9	238.0	279.0	321.0	363.5

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	1.7	1.5	1.4	1.1	1.2
EV/EBITDA	7.6	7.4	6.6	5.7	6.5
Adjusted P/E	10.6	10.6	9.5	9.3	9.2
P/BV	2.2	1.8	1.6	1.4	1.2

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	94.4	92.7
EBIT margin (EBIT/Revenue)	19.5	16.8	16.5	14.2	13.7
Asset turnover (Revenue/Avg TA)	28.2	26.1	25.4	25.8	23.1
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.5	1.5	1.5
Adjusted ROAE	23.1	18.8	17.8	15.7	13.9

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	14.8	24.6	2.5
EBITDA	9.8	4.8	17.9	14.4	2.9
Adjusted EPS	5.3	(0.4)	11.7	2.1	1.1
Profitability & Return ratios (%)					
EBITDA margin	22.9	20.2	20.8	19.1	19.1
EBIT margin	19.5	16.8	16.5	14.2	13.7
Adjusted profit margin	14.7	12.3	12.0	9.8	9.7
Adjusted ROAE	23.1	18.8	17.8	15.7	13.9
ROCE	22.8	18.2	17.2	15.2	13.2
Working capital days (days)					
Receivables	86	89	100	100	100
Inventory	130	135	120	110	110
Payables	58	50	60	60	60
Ratios (x)					
Gross asset turnover	2.1	1.9	1.8	1.4	1.3
Current ratio	2.8	2.9	3.0	2.8	2.8
Net interest coverage ratio	41.4	12.5	17.7	10.3	9.0
Adjusted debt/equity	0.3	0.4	0.3	0.5	0.4

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

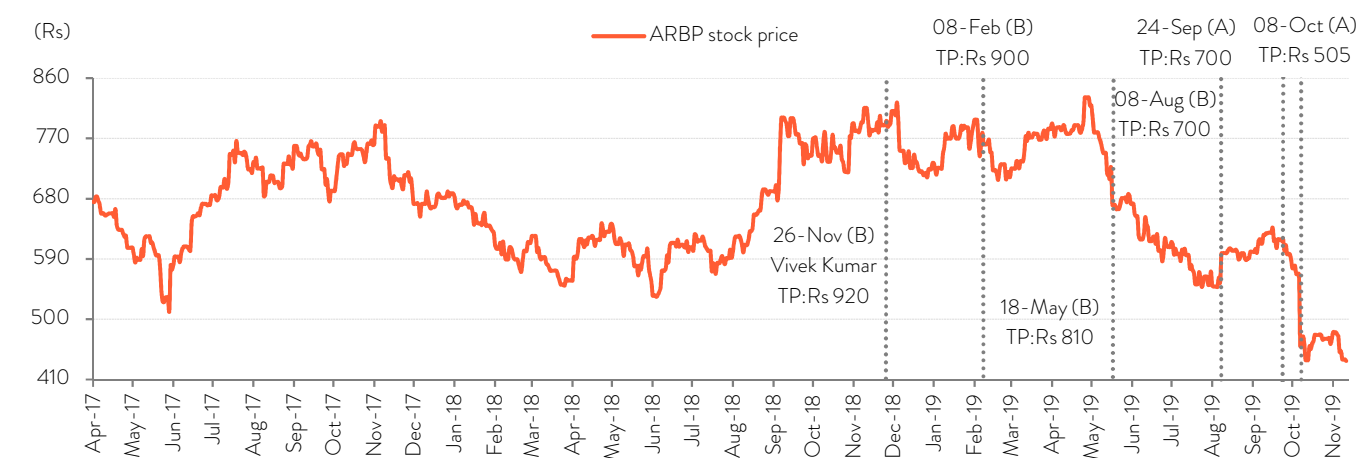
ADD – Expected return from >+5% to +15%

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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