

BUY

TP: Rs 635 | ▲ 30%

AUROBINDO PHARMA

| Pharmaceuticals

| 14 November 2022

Margin slippage continues; launches key for growth

- Q2 revenue dipped 3% YoY (-8% QoQ) to Rs 57bn as decline in US/Europe outweighed growth in other businesses
- EBITDA margin slipped for sixth straight quarter. Specialty business guidance of US\$ 650mn-700mn delayed by a year to FY25
- We cut FY23-FY24 EBITDA by 8-9% and lower our TP to Rs 635 (Rs 695 earlier); retain BUY

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Slowdown in US and Europe mars quarter: ARBP reported a revenue decline of 3% YoY (-8% QoQ) to Rs 57.4bn in Q2FY23, pulled down by US (-11% YoY/QoQ) and Europe sales (-9% YoY, -2% QoQ). This offset YoY and QoQ growth in other businesses barring antiretrovirals (ARV: -57% QoQ).

US business dynamics remain weak: US revenue fell 14% QoQ in constant currency terms to US\$ 331mn on account of a volume drop (~20%), price erosion (single-digit) and shelf stock adjustments for Vasopressin. Oral solids as well as injectables witnessed lower offtake due to inventory adjustments at wholesalers and distributors. Management views this as a temporary blip and expects normalcy to return in coming quarters. With a robust pipeline and ~40 planned launches over the next 12 months, management expects US business to grow hereon.

Specialty business guidance delayed: Given the sluggish offtake and oversupply, ARBP's near-term outlook on the US market remains weak. Hence, its earlier guidance of specialty sales reaching US\$ 650mn-700mn by FY24 stands delayed by a year.

No respite for margins: ARBP reported its sixth straight quarter of EBITDA margin contraction, hitting 14.6% in Q2 (-540bps YoY, -90bps QoQ). This can be attributed to gross margin slippage of 260bps YoY (+155bps QoQ) owing to pricing pressure in the US and a 20% YoY increase in SG&A spend, which nullified the 31% YoY cut in R&D spend for the quarter to 4.8% of revenue.

Retain BUY: We revise margin assumptions post H1FY23, leading to a reduction of 8-9% in our FY23-FY24 EBITDA estimates. Our new TP stands at Rs 635 (vs. Rs 695), based on an unchanged FY24E EV/EBITDA multiple of 7x (12x implied P/E). Our multiple reflects a continued 55% discount to other frontline stocks (SUNP, CIPLA, DRRD) due to ARBP's low branded sales and high US exposure. The stock is trading at attractive valuations of 6.4x/5.2x FY23E/FY24E EV/EBITDA – we maintain BUY as we see limited downside and are optimistic of traction in specialty sales and rising launch momentum.

Key changes

	Target	Rating
	▼	◀ ▶

Ticker/Price	ARBP IN/Rs 487
Market cap	US\$ 3.5bn
Free float	48%
3M ADV	US\$ 10.7mn
52wk high/low	Rs 742/Rs 457
Promoter/FPI/DII	52%/22%/16%

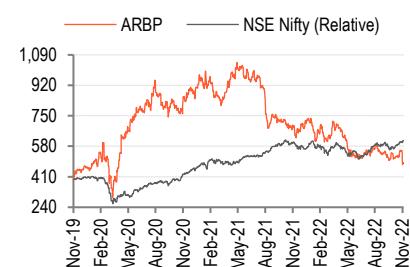
Source: NSE | Price as of 14 Nov 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	2,34,555	2,44,058	2,58,778
EBITDA (Rs mn)	43,868	43,114	49,730
Adj. net profit (Rs mn)	27,062	25,677	30,681
Adj. EPS (Rs)	46.2	43.8	52.4
Consensus EPS (Rs)	46.2	43.3	53.3
Adj. ROAE (%)	11.6	9.9	10.8
Adj. P/E (x)	10.6	11.1	9.3
EV/EBITDA (x)	6.8	6.4	5.2
Adj. EPS growth (%)	12.0	(5.1)	19.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Net Sales	57,394	59,419	(3.4)	62,359	(8.0)	1,19,753	1,16,439	2.8
EBITDA	8,369	11,867	(29.5)	9,647	(13.2)	18,016	23,961	(24.8)
Depreciation	2,981	2,942	-	2,795	-	5,776	5,739	-
EBIT	5,388	8,925	(39.6)	6,852	(21.4)	12,240	18,222	(32.8)
Interest	253	104	-	146	-	399	233	-
Other Income	572	947	-	406	-	978	1,760	-
PBT	5,707	9,768	(41.6)	7,112	(19.8)	12,819	19,749	(35.1)
Less: Taxation	1,130	2,709	-	1,586	-	2,716	5,187	-
Less: Minority Interest	22	108	-	38	-	60	198	-
Recurring PAT	4,555	6,951	(34.5)	5,488	(17.0)	10,043	14,365	(30.1)
Exceptional items	(461)	19	-	(283)	-	(744)	305	-
Reported PAT	4,094	6,970	(41.3)	5,205	(21.3)	9,299	14,670	(36.6)
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	55.3	57.8	(258)	53.7	155	54.5	58.2	(371)
EBITDA Margin	14.6	20.0	(539)	15.5	(89)	15.0	20.6	(553)
Tax / PBT	19.8	27.7	-	22.3	-	21.2	26.3	-
NPM	7.9	11.7	-	8.8	-	8.4	12.3	-
EPS (Rs)	7.8	11.9	-	9.4	-	17.1	24.5	-

Source: Company, BOBCAPS Research

Fig 2 – Revenue mix

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Formulations	47,700	51,612	(7.6)	53,294	(10.5)	1,00,994	1,00,510	0.5
US	26,376	29,676	(11.1)	29,711	(11.2)	56,087	56,488	(0.7)
Europe	15,162	16,623	(8.8)	15,481	(2.1)	30,643	32,452	(5.6)
EM	4,519	3,863	17.0	4,306	4.9	8,825	7,156	23.3
ARV	1,643	1,450	13.3	3,796	(56.7)	5,439	4,414	23.2
APIs	9,694	7,806	24.2	9,065	7.0	18,759	15,925	17.8
Net Sales	57,394	59,418	(3.4)	62,359	(8.0)	1,19,753	1,16,437	2.8
USDINR	80	74	7.7	77	3.4	78	74	6.1
US revenue (US\$ mn)	331	401	(17.5)	386	(14.2)	716	765	(6.4)

Source: Company, BOBCAPS Research

Earnings call highlights

- **Revenue:** ARBP's Q2FY23 revenue declined primarily on account of a 11% YoY (-11% QoQ) decline in US operations and a 9% YoY (-2% QoQ) fall in Europe. Other businesses such as emerging markets, ARVs and active pharma ingredients (API) posted YoY growth of 17% (+5% QoQ), 13% (-57%) and 24% (+7%) respectively.
- **US launches:** ARBP has been filing ~20 products every year in the US and expects to launch 20+ products in FY23 as well (and a total of 40 over the next 12 months). It also expects some limited-competition product approvals. gRevlimid rollout next year could provide a further impetus to sales.
- **Specialty sales guidance:** Management expects its earlier guidance of specialty sales reaching US\$ 650mn-700mn by FY24 to be delayed by a year to FY25 due to market conditions (volume drop, high channel inventory, pricing pressure). Specialty business also includes gRevlimid revenue potential (expected launch in H2FY24). Global injectable revenue for the quarter was ~US\$ 100mn.
- **Europe:** Europe (26% of revenue) declined 9% YoY (-2% QoQ) mainly due to depreciation of the euro. The topline in Euro terms was steady at EUR 190mn. Europe margins have strengthened because of supply chain disruptions faced by competitors. ARBP discontinued two lossmaking country operations in H1FY23. Sans these operations in the base quarter, the topline grew 3% YoY and EBITDA margin for Europe improved to 13%. Management believes the margin can reach 15% in coming quarters, further aided by biosimilars in oncology and injectables.
- **Vizag plant update:** The Vizag plant has not started supply. The company will manufacture exhibit batches this year and begin product filings from H1FY24 (across markets, including the US, EU and EMs). Revenue generation is expected by end-FY24.
- **Biosimilars:** The three biosimilars in Phase-3 efficacy trials are progressing as per management's expectations. ARBP expects one product approval in Europe from the existing filings, with revenues to kick in from Q3/Q4 of FY24. The company will set up an additional biosimilar plant in India at an outlay of Rs 3bn with 15kl of bioreactor capacity. Per management, this will be the largest monoclonal antibody manufacturing capacity in the country once operationalised (FY25-FY26).
- **Depo products:** ARBP has finished one depo product which is now on stability testing and expects to complete work on two more by the year-end, followed by filing with the USFDA from 2024 onwards.
- **Pen-G project:** The total outlay for the Penicillin-G project is US\$ 235mn. The target is to complete the facility by Mar'24 with a production capacity of 15,000mt.
- In the last 3-4 years, the company has transferred manufacturing of 55% of its products to India.
- **R&D:** R&D investments for Q3/Q4FY23 are guided to inch up to 6% given ongoing trials.

- **Net cash:** Net cash remains healthy at US\$ 337mn. The company is not considering a share buyback as it has already embarked on several projects such as Pen-G (US\$ 235mn outlay) and is setting up an additional biosimilar plant (Rs 3bn outlay).
- **Capex:** Investments of US\$ 125mn-150mn are planned per year.

Valuation methodology

We revise margin assumptions post H1FY23, leading to a reduction of 8-9% in our FY23-FY24 EBITDA estimates. Our new TP stands at Rs 635 (vs. Rs 695), based on an unchanged FY24E EV/EBITDA multiple of 7x (12x implied P/E). Our multiple reflects a continued 55% discount to other frontline stocks (SUNP, CIPLA, DRRD) due to ARBP's low branded sales and high US exposure. The stock is trading at attractive valuations of 6.4x/5.2x FY23E/FY24E EV/EBITDA – we maintain BUY as we see limited downside and are optimistic of traction in specialty sales and rising launch momentum.

Fig 3 – Revised estimates

(Rs bn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	F23E	FY24E
Revenue	244.1	258.8	250.1	265.1	(2.4)	(2.4)
EBITDA	43.1	49.7	46.6	54.8	(7.5)	(9.3)
EBITDA Margin (%)	17.7	19.2	18.6	20.7	(97bps)	(146bps)
EPS (Rs)	43.83	52.37	46.55	57.28	(5.8)	(8.6)

Source: BOBCAPS Research

Fig 4 – Key assumptions

Revenue (Rs bn)	FY22		FY23E	FY24E
	FY23E	FY24E	FY23E	FY24E
US		111.2	115.7	121.5
Europe		64.8	62.9	66.0
Emerging Markets		15.0	17.3	19.0
Antiretrovirals (ARV)		8.3	10.0	10.7
API		35.2	38.2	41.6
Dossier income		0.0	0.0	0.0

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY22-24E (%)	EV/EBITDA (x)		ROCE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Cipla	CIPLA IN	BUY	1,320	16.1	16.7	14.3	18.6	19.6	18.5
Dr. Reddy's	DRRD IN	HOLD	4,700	14.6	12.9	11.7	19.7	18.6	12.0
Sun Pharma	SUNP IN	HOLD	1,100	13.4	18.6	17.3	18.3	17.8	17.0
Aurobindo Pharma	ARBP IN	BUY	635	-	6.3	5.5	11.4	12.7	7.0

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- **Price erosion in the US:** ARBP is facing price erosion in the US market which is affecting margins. Any further increase in competitive intensity will ratchet up margin pressure.
- **US approval delays:** Delays in key approvals and execution hurdles are 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 earnings estimates.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.0	1,262	1,470	HOLD
Alembic Pharma	ALPM IN	1.5	640	615	HOLD
Alkem Labs	ALKEM IN	4.6	3,146	2,700	SELL
Aurobindo Pharma	ARBP IN	3.5	487	635	BUY
Cipla	CIPLA IN	11.2	1,130	1,320	BUY
Divi's Labs	DIVI IN	10.7	3,276	3,450	HOLD
Dr Reddy's Labs	DRRD IN	8.9	4,364	4,700	HOLD
Eris Lifesciences	ERIS IN	1.2	706	970	BUY
Glenmark Life Sciences	GLS IN	0.6	424	535	BUY
Laurus Labs	LAURUS IN	3.1	469	540	HOLD
Lupin	LPC IN	4.2	760	700	HOLD
Sun Pharma	SUNP IN	30.0	1,017	1,100	HOLD

Source: BOBCAPS Research, NSE | Price as of 14 Nov 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Total revenue	2,30,986	2,47,749	2,34,555	2,44,058	2,58,778
EBITDA	48,247	53,337	43,868	43,114	49,730
Depreciation	9,667	10,554	11,265	11,901	13,011
EBIT	38,580	42,783	32,603	31,214	36,719
Net interest inc./exp.)	(1,598)	(745)	(486)	(389)	(340)
Other inc./exp.)	862	2,773	2,504	2,095	3,467
Exceptional items	0	0	0	0	0
EBT	37,844	44,811	34,620	32,920	39,845
Income taxes	8,994	20,098	7,256	7,242	9,164
Extraordinary items	(261)	29,182	(580)	0	0
Min. int./inc. from assoc.	137	543	302	0	0
Reported net profit	28,452	53,351	26,482	25,677	30,681
Adjustments	261	(29,182)	580	0	0
Adjusted net profit	28,714	24,170	27,062	25,677	30,681

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Accounts payables	25,450	27,947	27,031	30,089	31,904
Other current liabilities	30,745	29,831	30,400	29,287	31,053
Provisions	4,914	3,291	3,424	3,562	3,777
Debt funds	56,867	52,373	28,513	22,810	19,959
Other liabilities	0	0	0	0	0
Equity capital	586	586	586	586	586
Reserves & surplus	1,68,912	2,19,923	2,46,378	2,69,145	2,96,897
Shareholders' fund	1,69,498	2,20,508	2,46,964	2,69,731	2,97,483
Total liab. and equities	2,87,473	3,33,950	3,36,331	3,55,480	3,84,176
Cash and cash eq.	28,422	54,680	41,900	63,033	85,235
Accounts receivables	43,552	35,033	40,123	40,119	42,539
Inventories	76,999	90,266	75,539	76,895	77,988
Other current assets	19,130	23,711	26,006	19,769	20,961
Investments	5,547	5,910	9,972	9,972	9,972
Net fixed assets	64,948	68,866	77,284	80,184	81,973
CWIP	19,859	30,615	37,472	37,472	37,472
Intangible assets	29,017	24,870	28,036	28,036	28,036
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	2,87,474	3,33,950	3,36,331	3,55,480	3,84,176

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Cash flow from operations	45,455	55,282	45,361	44,935	43,123
Capital expenditures	(17,500)	(14,000)	(14,800)	(14,800)	(14,800)
Change in investments	(1,945)	(363)	(4,061)	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(19,445)	(14,363)	(18,861)	(14,800)	(14,800)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(12,801)	(4,494)	(23,860)	(5,703)	(2,851)
Interest expenses	(1,598)	(745)	(486)	(389)	(340)
Dividends paid	(2,930)	(2,930)	(2,930)	(2,930)	(2,930)
Other financing cash flows	144	(6,492)	(12,003)	19	0
Cash flow from financing	(17,184)	(14,660)	(39,280)	(9,002)	(6,121)
Chg in cash & cash eq.	8,827	26,258	(12,780)	21,133	22,202
Closing cash & cash eq.	28,421	54,680	41,900	63,033	85,235

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22A	FY23E	FY24E
Reported EPS	48.6	91.1	45.2	43.8	52.4
Adjusted EPS	49.0	41.3	46.2	43.8	52.4
Dividend per share	2.5	2.5	2.5	2.5	2.5
Book value per share	289.6	376.8	422.0	460.9	508.3

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22A	FY23E	FY24E
EV/Sales	1.4	1.3	1.3	1.1	1.0
EV/EBITDA	6.8	6.1	6.8	6.4	5.2
Adjusted P/E	9.9	11.8	10.6	11.1	9.3
P/BV	1.7	1.3	1.2	1.1	1.0

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22A	FY23E	FY24E
Tax burden (Net profit/PBT)	75.9	53.9	78.2	78.0	77.0
Interest burden (PBT/EBIT)	98.1	104.7	106.2	105.5	108.5
EBIT margin (EBIT/Revenue)	16.7	17.3	13.9	12.8	14.2
Asset turnover (Rev./Avg TA)	26.5	24.8	21.4	21.5	21.2
Leverage (Avg TA/Avg Equity)	1.4	1.3	1.2	1.1	1.1
Adjusted ROAE	18.6	12.4	11.6	9.9	10.8

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
YoY growth (%)					
Revenue	18.1	7.3	(5.3)	4.1	6.0
EBITDA	22.1	10.5	(17.8)	(1.7)	15.3
Adjusted EPS	19.0	(15.8)	12.0	(5.1)	19.5
Profitability & Return ratios (%)					
EBITDA margin	20.9	21.5	18.7	17.7	19.2
EBIT margin	16.7	17.3	13.9	12.8	14.2
Adjusted profit margin	12.4	9.8	11.5	10.5	11.9
Adjusted ROAE	18.6	12.4	11.6	9.9	10.8
ROCE	18.1	18.2	12.8	11.7	13.2
Working capital days (days)					
Receivables	69	52	62	60	60
Inventory	122	133	118	115	110
Payables	40	41	42	45	45
Ratios (x)					
Gross asset turnover	1.9	1.8	1.6	1.5	1.4
Current ratio	2.8	3.3	3.0	3.2	3.4
Net interest coverage ratio	24.1	57.4	67.0	80.2	107.8
Adjusted debt/equity	0.2	0.0	(0.1)	(0.1)	(0.2)

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

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BUY – Expected return >+15%

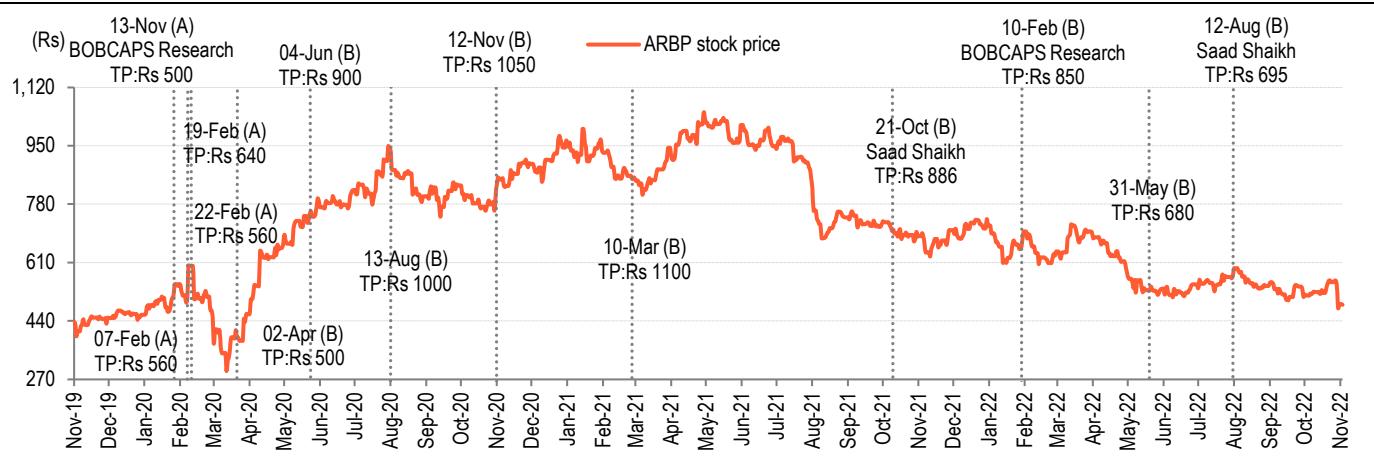
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): AUROBINDO PHARMA (ARBP IN)



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

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