

ADD

TP: Rs 560 | ▲ 10%

AUROBINDO PHARMA

Pharmaceuticals

07 February 2020

Q3 in line; facility resolution, Sandoz key stock catalysts

Aurobindo's (ARBP) operating results were in line, with above-expected US sales of US\$ 418mn (volume-led) but subdued gross margins at 56.5% (down 120bps QoQ) due to a higher ARV mix. Net debt declined by US\$ 77mn. This coupled with 2-3 months of stock amid potential coronavirus-led supply constraints are other positives. Management expects Sandoz approval latest by Mar'20 and CAPA implementation for Unit 4 by May. Nearing reinspection timelines for Unit 10 and Eugia are other near-term stock catalysts. Retain ADD.

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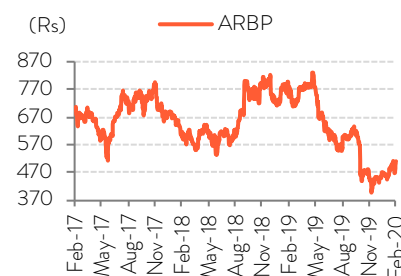
US beat key positive but EBITDA in line: ARBP saw best-ever US sales of US\$ 418mn in Q3 (+3% QoQ), led by new launches and volume growth in the base portfolio. Management believes the NBO opportunity might continue. Going ahead, Eugia will start contributing significantly in FY21 (currently only two products from this site). 9M US sales are tracking ahead of estimates, driving a 5% EPS upgrades for FY21/FY22. Spectrum's annualised sales of US\$ 100mn are tracking slightly above estimates. Injectable sales were flat QoQ at US\$ 76mn in Q3. EBITDA margin of 20.5% was in line. ARBP aims to be debt-free (outstanding net debt US\$ 446mn) in three years.

Ticker/Price	ARBP IN/Rs 511
Market cap	US\$ 4.2bn
Shares o/s	586mn
3M ADV	US\$ 23.8mn
52wk high/low	Rs 838/Rs 389
Promoter/FPI/DII	52%/19%/15%

Source: NSE

Near-term events to watch: While a final say on Unit 4 (injectable unit & ~5% of FY21E sales) is awaited, we believe Unit 10 and Eugia (together 55 pending ANDAs accounting for 42% of pending files) will come up for inspection in the next 3-4 months. Both units will be key growth drivers over the next 2-3 years.

STOCK PERFORMANCE



Source: NSE

ADD: Strong US sales despite facility challenges is a key positive in Q3. But stock valuations have turned reasonable from attractive post a 35% rally (trading at 8x FY21E EBITDA, 10% premium to peers). We revise Mar'21 TP to Rs 560 (from Rs 500), based on ~7x EV/EBITDA. Downside risks: Unit 4 escalation, Sandoz consolidation delays, 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	230,854	285,827	292,957
EBITDA (Rs mn)	37,718	39,519	47,118	55,500	57,116
Adj. net profit (Rs mn)	24,227	24,126	27,331	28,939	29,294
Adj. EPS (Rs)	41.3	41.2	46.6	49.4	50.0
Adj. EPS growth (%)	5.3	(0.4)	13.3	5.9	1.2
Adj. ROAE (%)	23.1	18.8	18.0	16.4	14.4
Adj. P/E (x)	12.3	12.4	10.9	10.3	10.2
EV/EBITDA (x)	8.9	8.4	7.3	6.2	6.5

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	Q3FY20E	Var (%)	9MFY20	9MFY19	YoY (%)
Net Sales	58,949	52,697	11.9	56,005	5.3	59,410	(0.8)	169,400	142,713	18.7
EBITDA	12,080	10,865	11.2	11,675	3.5	12,302	(1.8)	35,220	28,919	21.8
Depreciation	2,501	1,631	-	2,433	-	2,433	-	7,342	4,812	-
EBIT	9,579	9,234	3.7	9,242	3.6	9,869	-	27,878	24,107	15.6
Interest	371	476	-	409	-	600	-	1,279	1,125	-
Other Income	220	134	-	206	-	206	-	536	834	-
PBT	9,428	8,892	6.0	9,039	4.3	9,475	(0.5)	27,135	23,816	13.9
Less: Taxation	2,328	2,047	-	2,244	-	2,369	-	6,849	4,956	-
Less: Minority Interest	0	(26)	-	0	-	0	-	0	(22)	-
Recurring PAT	7,100	6,870	3.3	6,795	4.5	7,107	(0.1)	20,286	18,882	7.4
Exceptional items	(40)	247	-	(399)	-	0	-	(565)	(1,099)	-
Reported PAT	7,060	7,117	(0.8)	6,396	10.4	7,107	(0.7)	19,721	17,783	10.9
Key Ratios (%)										
Gross Margin	56.5	54.6	-	57.7	-	56.0	-	57.3	55.6	-
EBITDA Margin	20.5	20.6	-	20.8	-	20.7	-	20.8	20.3	-
Tax / PBT	24.7	23.0	-	24.8	-	25.0	-	25.2	20.8	-
NPM	12.0	13.0	-	12.1	-	12.0	-	12.0	13.2	-
EPS (Rs)	12.1	11.7	-	11.6	-	12.1	-	34.6	32.2	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	Q3FY20E	Var (%)	9MFY20	9MFY19	YoY (%)
Formulations	51,050	43,478	17.4	47,939	6.5	49,980	2.1	146,108	117,834	24.0
US	29,694	24,332	22.0	28,355	4.7	28,400	4.6	84,933	65,496	29.7
Europe	14,763	12,928	14.2	14,013	5.4	14,928	(1.1)	42,692	36,484	17.0
EM	3,459	3,405	1.6	3,192	8.4	3,473	(0.4)	9,785	9,045	8.2
ARV	3,134	2,813	11.4	2,379	31.7	3,179	(1.4)	8,698	6,809	27.7
APIs	7,898	9,218	(14.3)	8,058	(2.0)	9,422	(16.2)	23,278	24,864	(6.4)
Net Sales	58,951	52,696	11.9	56,005	5.3	59,410	(0.8)	169,386	142,718	18.7

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.

We assume a high probability of injectables Unit 4 being classified as OAI (official action indicated) by February-end – 90 days after the mandated 15-day response period that ended mid of Nov’19 – given that the USFDA has highlighted multiple red flags in its 14 observations. Also, ARBP had several Class 2 product recalls subsequently in Dec’19 from the unit. This unit has 34% of pending ANDAs. Moreover, Unit 10 and Eugia (together 55 pending ANDAs accounting for 42% of pending files) will be due for inspection in the next 3-4 months as they complete 12 months since the last FDA inspection.

The stock has moved up sharply by 30-35% since 14 Nov 2019 (led by favourable risk-reward) and is now trading at ~8x FY21E EBITDA which is 10% higher than global peers Teva, Endo and Perrigo.

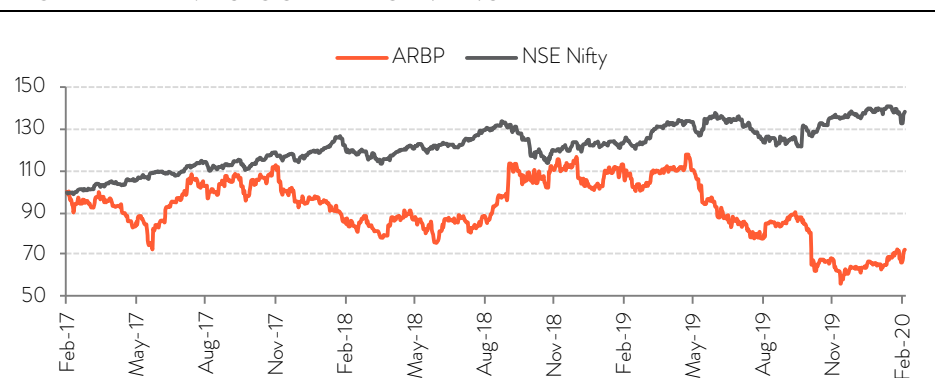
We raise FY21/FY22 EPS estimates by 5% each to factor in the strong US beat and management commentary of a sustained quarterly run-rate plus reduction in interest cost. This along with rollover of valuations drives a Mar’21 target price of Rs 560 (from Rs 500), based on ~7x EV/EBITDA. Maintain ADD. Key downside risks are Sandoz consolidation delays and penalty risk from Aceto supply-chain sabotage claim (in District Court).

FIG 3 – REVISED ESTIMATES

(Rs bn)	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Sales	230.9	285.8	293.0	224.5	279.7	286.6	2.8	2.2	2.2
EBITDA	47.1	55.5	57.1	46.6	53.3	54.9	1.1	4.1	4.1
EBITDA margin (%)	20.4	19.4	19.5	20.8	19.1	19.1	(35bps)	35bps	36bps
EPS (Rs)	47	49.4	50.0	46.0	47.0	47.5	1.4	5.2	5.3

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 (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 facilities are Unit 3, Unit 7, Unit 10, Eugia and Unit 4. Any adverse action by USFDA on these facilities can impact our EPS estimates.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	164,630	195,634	230,854	285,827	292,957
EBITDA	37,718	39,519	47,118	55,500	57,116
Depreciation	5,580	6,679	9,667	13,683	15,486
EBIT	32,138	32,839	37,451	41,817	41,631
Net interest income/(expenses)	(777)	(2,626)	(1,915)	(3,370)	(3,978)
Other income/(expenses)	1,020	1,157	905	925	790
Exceptional items	0	0	0	0	0
EBT	32,381	31,370	36,441	39,373	38,443
Income taxes	8,183	7,268	9,110	10,434	9,149
Extraordinary items	0	(483)	0	0	0
Min. int./Inc. from associates	(29)	(25)	0	0	0
Reported net profit	24,227	23,642	27,331	28,939	29,294
Adjustments	0	483	0	0	0
Adjusted net profit	24,227	24,126	27,331	28,939	29,294

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	26,274	26,771	37,949	46,985	48,157
Other current liabilities	15,324	24,390	20,777	25,724	26,366
Provisions	2,567	2,273	2,682	3,321	3,404
Debt funds	47,710	69,668	58,000	110,500	88,400
Other liabilities	0	0	0	0	0
Equity capital	586	586	586	586	586
Reserves & surplus	117,001	138,686	163,072	189,081	215,445
Shareholders' fund	117,587	139,272	163,657	189,667	216,031
Total liabilities and equities	209,462	262,374	283,065	376,197	382,358
Cash and cash eq.	12,616	19,594	16,601	9,840	12,742
Accounts receivables	38,788	47,771	56,923	78,309	80,262
Inventories	58,584	72,456	75,897	86,140	88,288
Other current assets	15,324	17,518	20,777	25,724	26,366
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	283,065	376,197	382,358

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	29,807	30,322	36,998	42,622	44,779
Interest expenses	777	2,626	1,915	3,370	3,978
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(12,847)	(15,780)	(7,878)	(21,953)	(2,847)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	17,737	17,168	31,034	24,039	45,910
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	(11,668)	52,500	(22,100)
Interest expenses	(777)	(2,626)	(1,915)	(3,370)	(3,978)
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	(16,528)	46,201	(29,008)
Changes in cash and cash eq.	7,482	6,978	(2,994)	(6,761)	2,902
Closing cash and cash eq.	12,616	19,594	16,600	9,840	12,742

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	41.3	40.4	46.6	49.4	50.0
Adjusted EPS	41.3	41.2	46.6	49.4	50.0
Dividend per share	2.5	2.5	2.5	2.5	2.5
Book value per share	200.9	238.0	279.7	324.1	369.2

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.0	1.7	1.5	1.2	1.3
EV/EBITDA	8.9	8.4	7.3	6.2	6.5
Adjusted P/E	12.3	12.4	10.9	10.3	10.2
P/BV	2.5	2.1	1.8	1.6	1.4

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	94.2	92.3
EBIT margin (EBIT/Revenue)	19.5	16.8	16.2	14.6	14.2
Asset turnover (Revenue/Avg TA)	28.2	26.1	26.8	27.4	24.2
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.4	1.5	1.5
Adjusted ROAE	23.1	18.8	18.0	16.4	14.4

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	18.0	23.8	2.5
EBITDA	9.8	4.8	19.2	17.8	2.9
Adjusted EPS	5.3	(0.4)	13.3	5.9	1.2
Profitability & Return ratios (%)					
EBITDA margin	22.9	20.2	20.4	19.4	19.5
EBIT margin	19.5	16.8	16.2	14.6	14.2
Adjusted profit margin	14.7	12.3	11.8	10.1	10.0
Adjusted ROAE	23.1	18.8	18.0	16.4	14.4
ROCE	22.8	18.2	17.8	16.4	14.0
Working capital days (days)					
Receivables	86	89	90	100	100
Inventory	130	135	120	110	110
Payables	58	50	60	60	60
Ratios (x)					
Gross asset turnover	2.1	1.9	1.9	1.4	1.4
Current ratio	2.8	2.9	2.8	2.6	2.7
Net interest coverage ratio	41.4	12.5	19.6	12.4	10.5
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%

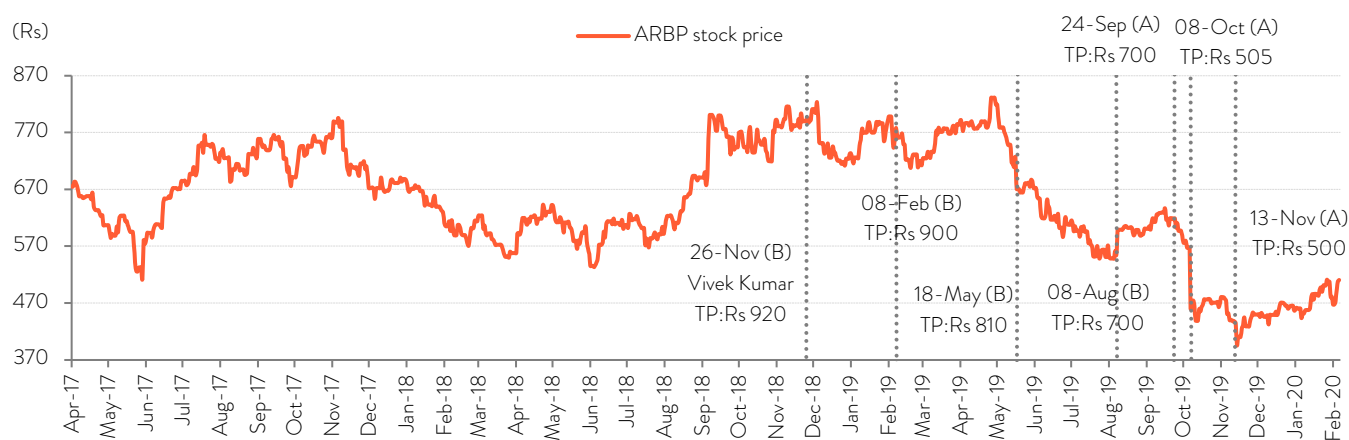
ADD – Expected return from >+5% to +15%

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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