

BUY

TP: Rs 850 | ▲ 24%

AUROBINDO PHARMA

Pharmaceuticals

10 February 2022

Headwinds continue; Plans India formulations foray

- Q3 revenue declined 6% YoY despite 48% growth in APIs as US (-13%) and ARV (-65%) business contracted
- US price erosion and high input & freight costs depleted gross/EBITDA margin by 530bps/460bps YoY
- We cut FY22/FY23 EBITDA by 16%/5% and reset our EV/EBITDA multiple to 7.5x (vs. 8.5x); on rollover, we have a TP of Rs 850 (vs. Rs 886) – BUY

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API sales recover; US and ARV businesses decline: ARBP reported a 6% YoY decline in Q3FY22 revenue primarily on account of a 13% drop in US business and a continued slowdown in ARVs (-65%). APIs reported a strong recovery with 48% YoY growth, benefitting from improved demand for key products.

US continues to see pricing pressure: US generics sales declined by 8% CC QoQ (ex-Natrol) to US\$ 369mn in Q3 vs. US\$ 400mn in Q2 due to heavy price erosion and high inventory with channel partners. With stronger competitive intensity all through FY22, ARBP has witnessed 9% YoY price erosion and shelf stock adjustment of US\$ 11mn in Q3 and US\$ 45mn in 9MFY22, while benefitting from only a miniscule penalty for non-supply during the contract period.

High input and freight costs weigh on margins: ARBP witnessed sharp gross margin contraction of 530bps YoY (-355bps QoQ) to 54.3% due to continued US price erosion and high input & freight costs, which shaved 460bps YoY (-300bps QoQ) off the EBITDA margin. Higher raw material costs and pricing headwinds had a negative impact of 150bps on gross margin, with a 125bps hit from an unfavourable product mix (strong API sales). RM and freight costs increased 8-10% YoY.

Domestic branded formulations foray: Given strong cash flow generation, ARBP has announced that it is actively evaluating an entry into the India formulations business through a combination of acquisitions and organic launches. The company plans to reach revenues of Rs 10bn in three years from the date of first launch. As per management, more clarity will emerge by Q1FY23.

Maintain BUY: The stock trades at attractive valuations of 6.9x/5.8x FY23E/ FY24E EV/EBITDA. We cut our FY22/FY23 EBITDA estimates by 15%/5% to factor in the Q3 performance – retain BUY with a revised TP of Rs 850 (Rs 886 earlier) as we roll valuations forward to FY24 and move to a lower 7.5x EV/EBITDA multiple (8.5x earlier), implying a P/E of 12x. Our target multiple reflects a continued 45% discount to other frontline stocks (SUNP, CIPLA, DRRD) due to ARBP's low branded sales and high US exposure.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	ARBP IN/Rs 684
Market cap	US\$ 5.4bn
Free float	48%
3M ADV	US\$ 19.1mn
52wk high/low	Rs 1,064/Rs 590
Promoter/FPI/DII	52%/22%/16%

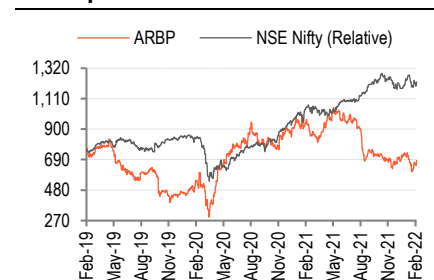
Source: NSE | Price as of 10 Feb 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	2,47,746	2,38,108	2,64,197
EBITDA (Rs mn)	53,334	45,792	55,779
Adj. net profit (Rs mn)	25,203	27,825	34,726
Adj. EPS (Rs)	43.0	47.5	59.3
Consensus EPS (Rs)	43.0	52.0	59.2
Adj. ROAE (%)	12.9	11.9	13.3
Adj. P/E (x)	15.9	14.4	11.5
EV/EBITDA (x)	8.3	9.0	6.9
Adj. EPS growth (%)	(12.2)	10.4	24.8

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Net Sales	60,022	63,649	(5.7)	59,419	1.0	1,76,461	1,87,731	(6.0)
EBITDA	10,163	13,686	(25.7)	11,867	(14.4)	34,124	40,588	(15.9)
Depreciation	2,991	2,765	-	2,942	-	8,730	7,894	-
EBIT	7,172	10,921	(34.3)	8,925	(19.6)	25,394	32,694	(22.3)
Interest	161	195	-	104	-	394	563	-
Other Income	452	728	-	947	-	2,212	2,134	-
PBT	7,463	11,455	(34.8)	9,768	(23.6)	27,212	34,266	(20.6)
Less: Taxation	1,895	10,575	-	2,709	-	7,081	17,444	-
Less: Minority Interest	67	143	-	108	-	264	464	-
Recurring PAT	5,502	737	646.8	6,951	(20.8)	19,867	16,358	21.5
Exceptional items	546	28,745	-	19	-	850	29,032	-
Reported PAT	6,047	29,481	(79.5)	6,970	(13.2)	20,717	45,390	(54.4)
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	54.3	59.6	(531)	57.8	(355)	56.8	60.1	-
EBITDA Margin	16.9	21.5	(457)	20.0	(304)	19.3	21.6	-
Tax / PBT	25.4	92.3	-	27.7	-	26.0	50.9	-
NPM	9.2	1.2	-	11.7	-	11.3	8.7	-
EPS (Rs)	9.4	1.3	-	11.9	-	33.9	27.9	21.5

Source: Company, BOBCAPS Research

Fig 2 – Sales mix

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Formulations	49,922	56,824	(12.1)	51,612	(3.3)	1,50,432	1,56,812	(4.1)
US	27,452	31,716	(13.4)	29,676	(7.5)	83,940	86,691	(3.2)
Europe	16,943	16,712	1.4	16,623	1.9	49,395	45,082	9.6
EM	3,970	3,962	0.2	3,863	2.8	11,126	11,323	(1.7)
ARV	1,557	4,434	(64.9)	1,450	7.4	5,971	13,716	(56.5)
APIs	10,100	6,825	48.0	7,806	29.4	26,025	22,916	13.6
Net Sales	60,022	63,649	(5.7)	59,418	1.0	1,76,445	1,79,728	(1.8)
USDINR	74	74	1.0	74	0.1	74	74	(0.5)
US revenue (US\$ mn)	369	431	(14.3)	400	(7.6)	1,133	1,164	(2.7)

Source: Company, BOBCAPS Research

Earnings call highlights

- **IPR purchase on global assets:** With the purchase of ANDAs worth US\$ 34mn in Q3 and US\$ 150mn in 9MFY22, ARBP has acquired IPR in key areas where it lacks a presence. Management has guided that the IPR investments for a medium-term horizon are nearly complete. The company has purchased 40 IPRs, of which 31 are in orals, 3 in dermatology and the rest in injectables.
- **New launches in the US:** Management has guided for the launch of key injectables from Q1FY23 out of the Eugia plant, as large complex injectables are going off-patent. ARPB plans to launch 10-15 products in FY23 with average originator product size of US\$ 650mn-700mn. The current US revenue run-rate is at US\$ 60mn-65mn per quarter and the company expects to reach US\$ 100mn-110mn per quarter in FY23 with double-digit growth.
- **Margin headwinds:** Higher raw material costs and pricing headwinds had a negative impact of 150bps on the Q3FY22 gross margin, with a 125bps hit from an unfavourable product mix (strong API sales). RM and freight costs rose 8-10% YoY.
- **India formulations foray:** ARBP plans to foray into India formulations and is targeting revenue of Rs 10bn in three years. It will explore the organic and acquisition route to expand its portfolio in India. Better clarity on its business plans is likely to emerge in FY23
- **Biosimilar development:** The company plans to launch seven biosimilars (in oncology and immunosuppressants) in the EU and US, of which three are in trials while two are filed and expected to be approved within a nine-month window.
- **Inventory:** Given a large inventory pile-up in the supplier network industrywide for US generics, ARBP expects to reduce inventory further by US\$ 100mn in the near term and even beyond this level over the medium-to-long term. The rationalisation process will help reduce its working capital requirement.
- **Regulatory requirements:** Management has appointed a globally reputed consultant after the USFDA issued a warning letter for the Unit-1. The company plans to shut down its older plant (Unit-1) after lingering regulatory uncertainty for over three years. A USFDA audit is underway at Unit-5 – a sterile API plant. The two injectable plants, Eugia and Unit-1, are scheduled for audits this year as well.
- **PLI scheme update:** ARBP has spent Rs 5bn to buy land and on construction thus far for a plant under the government's PLI scheme. It has received a one-year extension to commence production and plans to start from Q4FY24. It further aims to build up capacity of the 15,000 Kiloliter API plant at a capex of Rs 18.5bn and to receive incentives of Rs 14bn. Post negotiations with the government, its PLI project dropped production of 7ACA and D7ACA (low demand) while continuing to produce Penicillin-G APIs.

Valuation methodology

ARBP continues to face challenges in the US market in terms of pricing erosion and raw material price inflation, which have dampened gross and EBITDA margins over the past few quarters, in line with the industry. Its ARV sales have declined 57% YoY in 9MFY22 primarily due to lower demand off a higher base and shelf stock adjustments. We cut our FY22/FY23 EBITDA estimates by 16%/5% to factor in the margin headwinds.

Nevertheless, we are optimistic about the company's growth prospects on the back of the injectables business where management has a target of achieving US\$ 650mn-700mn in sales by FY24. This apart, ARBP has announced its foray into the domestic branded formulations market and expects to achieve revenue of Rs 10bn in a three-year timeframe.

On the valuation front, we find the stock attractive at current levels of 6.9x/5.8x FY23E/FY24E EV/EBITDA. We retain BUY with a revised TP of Rs 850 (Rs 886 earlier) as we roll valuations forward to FY24 and move to a lower 7.5x EV/EBITDA multiple (8.5x earlier), implying a P/E of 12x. Our target multiple reflects a continued 45% discount to other frontline stocks (SUNP, CIPLA, DRRD) due to ARBP's low branded sales and high US exposure.

Fig 3 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Sales	238.4	264.6	293.6	253.8	268.2	279.8	(6.1)	(1.3)	5.0
EBITDA	45.9	55.9	65.4	54.1	58.6	61.6	(15.1)	(4.6)	6.1
EBITDA margin (%)	19.26	21.14	22.27	21.30	21.86	22.03	(205bps)	(72bps)	24bps
EPS (Rs)	47.65	59.47	70.84	57.00	62.47	66.81	(16.4)	(4.8)	6.0

Source: BOBCAPS Research

Fig 4 – Key assumptions

Revenue (Rs bn)	FY21	FY22E	FY23E	FY24E
US	123.2	113.1	130.1	149.6
Europe	60.6	65.8	69.7	73.8
EM	14.4	15.1	16.9	18.9
ARV	18.6	7.9	10.7	13.4
API	30.9	36.1	36.8	37.4
Dossier Income	0.0	0.0	0.0	0.0

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY21-24E (%)	EV/EBITDA (x)		ROE (%)		Target P/E (x)
					FY23E	FY24E	FY23E	FY24E	
Aurobindo	ARBP IN	BUY	850	6.9	6.5	5.6	13.3	13.9	7.5
Cipla	CIPLA IN	BUY	1,160	11.0	14.5	12.8	13.6	14.5	16.0
Dr. Reddy's	DRRD IN	HOLD	4,700	10.6	12.1	11.5	17.2	15.5	12.5
Sun Pharma	SUNP IN	BUY	1,045	14.9	16.9	15.1	16.1	16.1	18.0

Source: BOBCAPS Research

Key risks

- **Price erosion in the US:** ARBP is facing price erosion in the US market which is affecting its margins. Any further increase in competitive intensity will further 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	2.4	2,059	2,655	BUY
Alembic Pharma	ALPM IN	2.0	758	980	BUY
Alkem Labs	ALKEM IN	5.6	3,501	4,000	HOLD
Aurobindo Pharma	ARBP IN	5.4	684	850	BUY
Cipla	CIPLA IN	10.5	975	1,160	BUY
Divi's Labs	DIVI IN	15.3	4,314	5,540	HOLD
Dr Reddy's Labs	DRRD IN	9.7	4,371	4,700	HOLD
Eris Lifesciences	ERIS IN	1.3	699	890	BUY
Laurus Labs	LAURUS IN	3.9	540	570	HOLD
Sun Pharma	SUNP IN	28.6	894	1,045	BUY

Source: BOBCAPS Research, NSE | Price as of 10 Feb 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	2,30,986	2,47,746	2,38,108	2,64,197	2,93,199
EBITDA	48,247	53,334	45,792	55,779	65,220
Depreciation	9,667	10,554	11,798	13,487	14,745
EBIT	38,580	42,780	33,994	42,291	50,475
Net interest inc./(exp.)	(1,598)	(745)	(545)	(385)	(270)
Other inc./(exp.)	862	3,808	3,650	4,395	4,947
Exceptional items	0	0	0	0	0
EBT	37,844	45,844	37,100	46,301	55,152
Income taxes	8,994	20,098	9,275	11,575	13,788
Extraordinary items	(261)	28,146	500	0	0
Min. int./Inc. from assoc.	137	543	0	0	0
Reported net profit	28,452	53,349	28,325	34,726	41,364
Adjustments	261	(28,146)	(500)	0	0
Adjusted net profit	28,714	25,203	27,825	34,726	41,364

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	25,450	27,947	32,618	36,191	40,164
Other current liabilities	30,745	29,831	28,573	31,704	35,184
Provisions	4,914	3,291	3,162	3,509	3,894
Debt funds	56,867	52,373	41,898	33,519	23,463
Other liabilities	0	0	0	0	0
Equity capital	586	586	586	586	586
Reserves & surplus	1,68,912	2,19,923	2,45,327	2,77,123	3,15,558
Shareholders' fund	1,69,498	2,20,509	2,45,913	2,77,709	3,16,144
Total liab. and equities	2,87,473	3,33,950	3,52,164	3,82,632	4,18,849
Cash and cash eq.	28,422	54,680	67,000	79,512	97,173
Accounts receivables	43,552	35,033	58,712	65,145	72,296
Inventories	76,999	90,266	71,759	79,621	88,361
Other current assets	19,130	23,711	21,430	23,778	26,388
Investments	5,547	5,910	5,910	5,910	5,910
Net fixed assets	64,948	68,866	71,868	73,181	73,235
CWIP	19,859	30,615	30,615	30,615	30,615
Intangible assets	29,017	24,870	24,870	24,870	24,870
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	2,87,474	3,33,950	3,52,164	3,82,632	4,18,849

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	45,455	55,279	41,061	39,006	45,716
Capital expenditures	(17,500)	(14,000)	(14,800)	(14,800)	(14,800)
Change in investments	(1,945)	(363)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(19,445)	(14,363)	(14,800)	(14,800)	(14,800)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(12,800)	(4,494)	(10,475)	(8,380)	(10,056)
Interest expenses	(1,598)	(745)	(545)	(385)	(270)
Dividends paid	(2,930)	(2,930)	(2,930)	(2,930)	(2,930)
Other financing cash flows	144	(6,489)	9	0	0
Cash flow from financing	(17,184)	(14,658)	(13,940)	(11,695)	(13,255)
Chg in cash & cash eq.	8,827	26,258	12,321	12,512	17,661
Closing cash & cash eq.	28,421	54,680	67,001	79,512	97,173

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	48.6	91.1	48.3	59.3	70.6
Adjusted EPS	49.0	43.0	47.5	59.3	70.6
Dividend per share	2.5	2.5	2.5	2.5	2.5
Book value per share	289.6	376.8	420.2	474.6	540.2

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	1.9	1.8	1.7	1.5	1.2
EV/EBITDA	9.2	8.3	9.0	6.9	5.6
Adjusted P/E	14.0	15.9	14.4	11.5	9.7
P/BV	2.4	1.8	1.6	1.4	1.3

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	75.9	55.0	75.0	75.0	75.0
Interest burden (PBT/EBIT)	98.1	107.2	109.1	109.5	109.3
EBIT margin (EBIT/Revenue)	16.7	17.3	14.3	16.0	17.2
Asset turnover (Rev./Avg TA)	26.5	24.8	21.2	22.1	22.5
Leverage (Avg TA/Avg Equity)	1.4	1.3	1.2	1.1	1.1
Adjusted ROAE	18.6	12.9	11.9	13.3	13.9

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	18.1	7.3	(3.9)	11.0	11.0
EBITDA	22.1	10.5	(14.1)	21.8	16.9
Adjusted EPS	19.0	(12.2)	10.4	24.8	19.1
Profitability & Return ratios (%)					
EBITDA margin	20.9	21.5	19.2	21.1	22.2
EBIT margin	16.7	17.3	14.3	16.0	17.2
Adjusted profit margin	12.4	10.2	11.7	13.1	14.1
Adjusted ROAE	18.6	12.9	11.9	13.3	13.9
ROCE	18.1	18.7	13.4	15.6	17.0
Working capital days (days)					
Receivables	69	52	90	90	90
Inventory	122	133	110	110	110
Payables	40	41	50	50	50
Ratios (x)					
Gross asset turnover	1.9	1.8	1.6	1.6	1.6
Current ratio	2.8	3.3	3.4	3.5	3.6
Net interest coverage ratio	24.1	57.4	62.4	109.7	187.1
Adjusted debt/equity	0.2	0.0	(0.1)	(0.2)	(0.2)

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

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

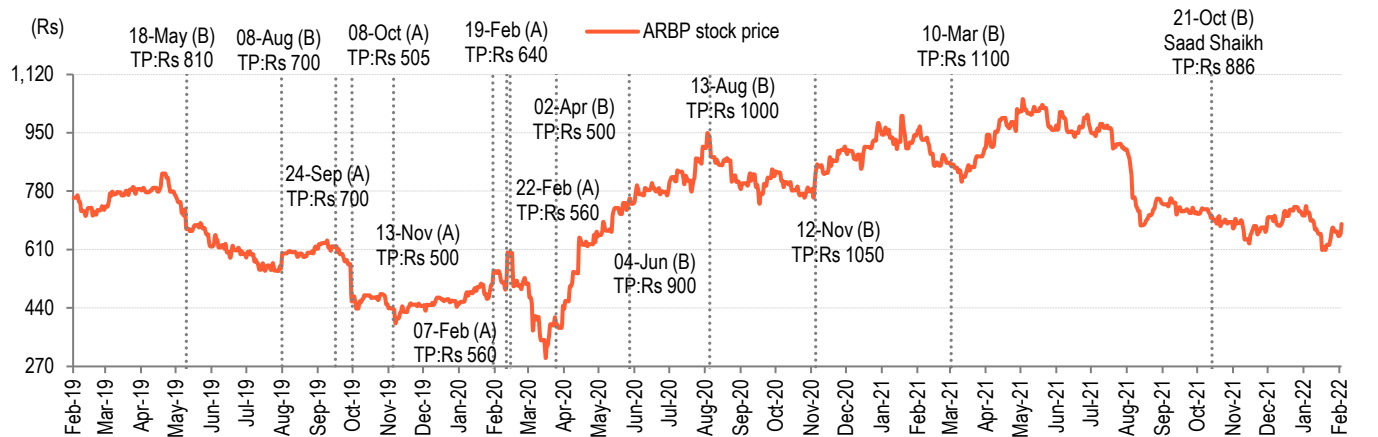
HOLD – Expected return from -6% to +15%

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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