

**BUY**

TP: Rs 635 | ▲ 35%

**AUROBINDO PHARMA**

Pharmaceuticals

11 February 2023

### Modest Q3; no respite on margin front

- Q3 revenue up 7% YoY to Rs 64bn led by growth in the US and EMs along with recovery in ARV business
- EBITDA/PAT disappoint (-6%/-19% YoY) on higher R&D expense, finance cost and taxes; EBITDA margin down 200bps YoY
- We lower FY23-FY24 EPS by ~15% each; on rollover, our TP remains at Rs 635

Saad Shaikh

research@bobcaps.in

**Growth in US & EM; ARVs recover:** ARBP reported 7% YoY growth in Q3FY23 revenue to Rs 64.1bn led by growth in the US and emerging markets, along with recovery in the antiretroviral (ARV) formulation business while sales of active pharma ingredients (API) declined YoY as well as QoQ. Europe business grew 12% QoQ on account of increased sales in France and Germany.

**Injectable launches boost US sales:** US revenue clocked in at US\$ 366mn, rising 10% QoQ in Q3, primarily led by the injectables business which grew 40% QoQ to US\$ 105mn (forming 29% of US sales). ARBP launched six injectable products in the US market during the quarter. Management is optimistic about reaching its US\$ 650mn guidance for specialty/injectable sales by FY25. US revenue in Q3 was further supported by seasonality in some products as well as incremental demand as a result of adverse regulatory observations for a few competitors.

**Gross margin stable; higher R&D cost impacts EBITDA margin:** Gross margin for the quarter held at 54.6% (+30bps YoY/-65bps QoQ), but higher R&D spend of Rs 4.2bn (6.5% of sales) due to biosimilar clinical studies on three products dragged EBITDA margin down to 14.9% (-200bps YoY/+30bps QoQ). R&D spend as a percentage of sales is at peak levels and guided to remain in the 6-6.5% range.

**Open to buyback:** Given the attractive valuations at 6.2x/5.4x FY24E/FY25E EV/EBITDA, management has indicated that the company might be open to a share buyback. A final decision would be taken by the board at its next meeting in May.

**Retain BUY:** We cut FY23-FY24 EPS estimates by 15-16% due to the below-expected margin and higher tax rate and interest outgo in Q3. We continue to value ARBP at 7x EV/EBITDA – a 25% discount to the 5Y average, while rolling valuations over to FY25E, leaving our TP unchanged at Rs 635. We believe launch momentum and growing specialty sales would enable ARBP to retain market share in the US. Further, the ambitious Penicillin-G project, biosimilar launches and scale-up of domestic formulations should help the company generate strong cash flows beyond FY24. BUY.

### Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	ARBP IN/Rs 469
Market cap	US\$ 3.3bn
Free float	48%
3M ADV	US\$ 9.4mn
52wk high/low	Rs 728/Rs 397
Promoter/FPI/DII	52%/22%/16%

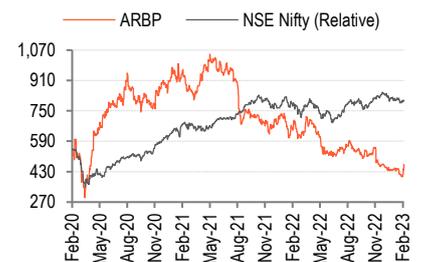
Source: NSE | Price as of 10 Feb 2023

### 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	38,114	44,142
Adj. net profit (Rs mn)	27,062	21,498	26,201
Adj. EPS (Rs)	46.2	36.7	44.7
Consensus EPS (Rs)	46.2	36.6	46.6
Adj. ROAE (%)	11.6	8.4	9.5
Adj. P/E (x)	10.2	12.8	10.5
EV/EBITDA (x)	6.6	7.0	5.7
Adj. EPS growth (%)	12.0	(20.6)	21.9

Source: Company, Bloomberg, BOBCAPS Research

### Stock performance



Source: NSE



**Fig 1 – Quarterly performance**

(Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	9MFY23	9MFY22	YoY (%)
<b>Net Sales</b>	<b>64,071</b>	<b>60,022</b>	<b>6.7</b>	<b>57,394</b>	<b>11.6</b>	<b>1,83,824</b>	<b>1,76,461</b>	<b>4.2</b>
<b>EBITDA</b>	<b>9,544</b>	<b>10,163</b>	<b>(6.1)</b>	<b>8,369</b>	<b>14.0</b>	<b>27,560</b>	<b>34,124</b>	<b>(19.2)</b>
Depreciation	3,214	2,991	-	2,981	-	8,990	8,730	-
<b>EBIT</b>	<b>6,330</b>	<b>7,172</b>	<b>(11.7)</b>	<b>5,388</b>	<b>17.5</b>	<b>18,570</b>	<b>25,394</b>	<b>(26.9)</b>
Interest	450	161	-	253		849	394	-
Other Income	927	452	-	572	--	1,905	2,212	-
<b>PBT</b>	<b>6,807</b>	<b>7,463</b>	<b>(8.8)</b>	<b>5,707</b>	<b>19.3</b>	<b>19,626</b>	<b>27,212</b>	<b>(27.9)</b>
Less: Taxation	1,891	1,895	-	1,130	-	4,607	7,081	-
Less: Minority Interest	3	67	-	22	-	63	264	-
<b>Recurring PAT</b>	<b>4,913</b>	<b>5,502</b>	<b>(10.7)</b>	<b>4,555</b>	<b>7.8</b>	<b>14,956</b>	<b>19,867</b>	<b>(24.7)</b>
Exceptional items	0	546	-	(461)	-	(744)	850	-
<b>Reported PAT</b>	<b>4,913</b>	<b>6,047</b>	<b>(18.8)</b>	<b>4,094</b>	<b>20.0</b>	<b>14,212</b>	<b>20,717</b>	<b>(31.4)</b>
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
Gross Margin	54.6	54.3	34	55.3	(64)	54.5	56.8	-
EBITDA Margin	14.9	16.9	(204)	14.6	31	15.0	19.3	-
Tax / PBT	27.8	25.4	-	19.8	-	23.5	26.0	-
NPM	7.7	9.2	-	7.9	-	8.1	11.3	-
EPS (Rs)	8.4	9.4	-	7.8	-	25.5	33.9	(24.7)

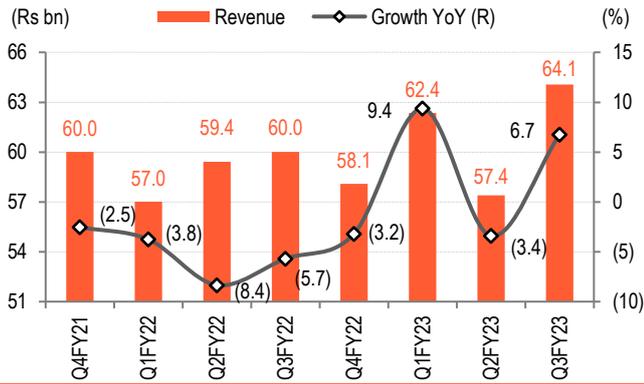
Source: Company, BOBCAPS Research

**Fig 2 – Segmental performance**

(Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	9MFY23	9MFY22	YoY (%)
Formulations	54,525	49,922	9.2	47,700	14.3	1,55,519	1,50,432	3.4
US	30,012	27,452	9.3	26,376	13.8	86,099	83,940	2.6
Europe	17,012	16,943	0.4	15,162	12.2	47,655	49,395	(3.5)
EM	4,989	3,970	25.7	4,519	10.4	13,814	11,126	24.2
ARV	2,512	1,557	61.3	1,643	52.9	7,951	5,971	33.2
APIs	9,546	10,100	(5.5)	9,694	(1.5)	28,305	26,025	8.8
<b>Net Sales</b>	<b>64,071</b>	<b>60,022</b>	<b>6.7</b>	<b>57,394</b>	<b>11.6</b>	<b>1,83,824</b>	<b>1,76,461</b>	<b>4.2</b>
USDINR	82	75	9.6	80	3.0	80	74	7.3
US revenue (US\$ mn)	366	367	(0.2)	331	10.5	1,083	1,132	(4.4)

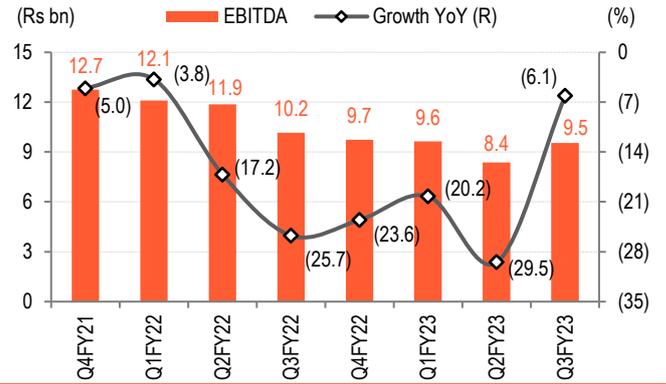
Source: Company, BOBCAPS Research

**Fig 3 – Revenue**



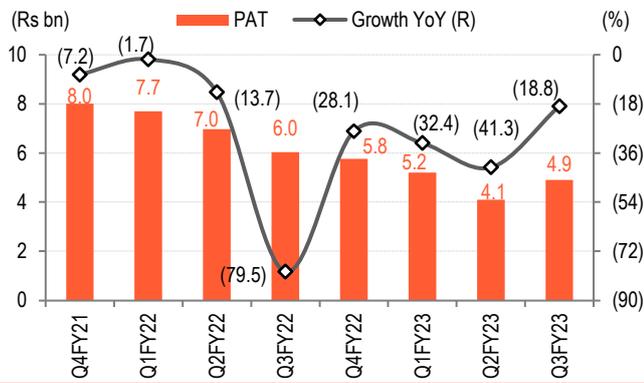
Source: Company, BOBCAPS Research

**Fig 4 – EBITDA**



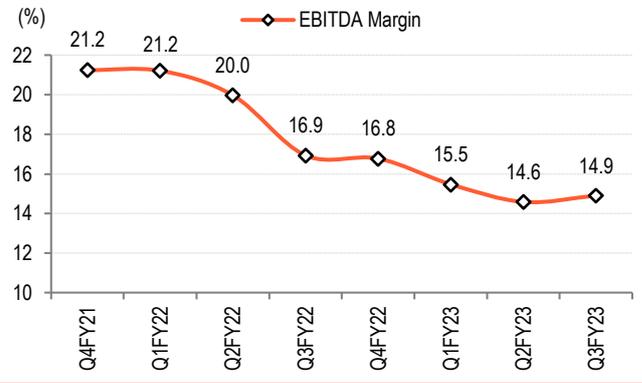
Source: Company, BOBCAPS Research

**Fig 5 – PAT**



Source: Company, BOBCAPS Research

**Fig 6 – EBITDA Margin**



Source: Company, BOBCAPS Research

## Earnings call highlights

- **US:** ARBP indicated that it saw good demand and volumes with stable pricing in Q3FY23. Seasonality in some products and regulatory compliance issues at competitors also aided revenue growth. The launch of six injectable products buoyed US business. Management expects double-digit growth QoQ in the injectables business.
- **R&D:** R&D spend of Rs 4bn (6.5% of revenue) in Q3 was on the higher side due to biosimilar clinical studies on three products. R&D spend as a percentage of sales is at peak levels and guided to remain in the 6-6.5% range.
- **Biosimilars:** ARBP has three biosimilar products in phase-3 clinical trials. The company has filed two biosimilars in Europe and one oncology monoclonal antibody in the UK (inspection pending). It plans to bring an immunology biosimilar (dermatology) to the US market in FY25. Acrotech Biopharma will position biosimilar brands in the US.
- **New launches:** gRevlimid is projected to be a Q3FY24 launch. ARBP is looking to commercialise 40 products over the next 12 months.
- **Penicillin-G project:** The installation is due for completion by September-October this year, with a pilot batch by November-December. Pen-G is expected to be a key cost saver as 7,000t of the total 15,000t capacity would be consumed inhouse. Management believes this can help take EBITDA margin to historical levels of 20%.
- **Freight cost:** Cost has improved significantly from Q1 to Q2 and also in Q3FY23.
- **API units:** ARBP has brought all API units under one roof to improve efficiency, raise regulatory compliance and mitigate risk. The move has no tax implications.
- **Formulation compliance:** All units have VAI (voluntary action indicated) observations.
- **Cash generation:** Management expects high cash flow generation from FY25 aided by the Pen-G project as well as the biosimilars business.
- **Corporate governance:** ARBP has added one more independent director – 50% of its directors (5 of 10) are now independent.

## Valuation methodology

ARBP is trading at attractive valuations of 6.2x/5.4x FY24E/FY25E EV/EBITDA. Due to the below-expected margin and higher tax rate and interest outgo in Q3FY23, we scale back our FY23-FY24 EPS estimates by 15-16%. We continue to value the stock at 7x EV/EBITDA – a 25% discount to the five-year average, while rolling valuations over to FY25E, leaving our TP unchanged at Rs 635.

ARBP has witnessed stable pricing in Q3FY23 (unlike the previous few quarters) and with new launch momentum, we expect the company to retain market share in the US, to be further supported by the FY24 launch of gRevlimid. Management has guided for specialty business to reach ~US\$ 650mn by FY25. This apart, the ambitious Penicillin-G project, biosimilar launches and scale-up of domestic formulations should help the company generate strong cash flows beyond FY24.

Retain BUY.

**Fig 7 – Revised estimates**

(Rs bn)	New			Old			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Sales	244.1	258.8	274.5	244.1	258.8	NA	0.0	0.0	-
EBITDA	38.1	44.1	49.9	43.1	49.7	NA	(11.6)	(11.2)	-
EBITDA margin (%)	15.6	17.1	18.2	17.7	19.2	NA	(205bps)	(216bps)	-
EPS (Rs)	36.7	44.7	52.2	43.8	52.4	NA	(16.3)	(14.6)	-

Source: BOBCAPS Research

**Fig 8 – Key assumptions**

Revenue (Rs bn)	FY22	FY23E	FY24E	FY25E
US	111.2	115.7	121.5	127.5
Europe	64.8	62.9	66.0	69.3
Emerging Markets (EM)	15.0	17.3	19.0	20.9
Antiretrovirals (ARV)	8.3	10.0	10.7	11.4
API	35.2	38.2	41.6	45.3

Source: Company, BOBCAPS Research

## Key risks

Key downside risks to our estimates are:

- **Price erosion in the US:** ARBP has been 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	1.9	1,208	1,470	HOLD
Alembic Pharma	ALPM IN	1.2	525	615	HOLD
Alkem Labs	ALKEM IN	4.8	3,293	2,700	SELL
Aurobindo Pharma	ARBP IN	3.3	469	635	BUY
Cipla	CIPLA IN	10.1	1,033	1,250	BUY
Divi's Labs	DIVI IN	9.0	2,811	3,200	HOLD
Dr Reddy's Labs	DRRD IN	9.1	4,500	4,700	HOLD
Eris Lifesciences	ERIS IN	1.1	643	810	BUY
Glenmark Life Sciences	GLS IN	0.6	379	585	BUY
Laurus Labs	LAURUS IN	2.2	340	540	HOLD
Lupin	LPC IN	4.1	737	700	HOLD
Sun Pharma	SUNP IN	29.2	1,007	1,100	HOLD

Source: BOBCAPS Research, NSE | Price as of 10 Feb 2023

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
<b>Total revenue</b>	<b>2,47,749</b>	<b>2,34,555</b>	<b>2,44,058</b>	<b>2,58,778</b>	<b>2,74,470</b>
EBITDA	53,337	43,868	38,114	44,142	49,897
Depreciation	10,554	11,265	11,901	13,011	14,121
EBIT	42,783	32,603	26,214	31,131	35,776
Net interest inc./(exp.)	(745)	(486)	(389)	(340)	(272)
Other inc./(exp.)	2,773	2,504	2,095	3,237	4,212
Exceptional items	0	0	0	0	0
EBT	44,811	34,620	27,920	34,028	39,716
Income taxes	20,098	7,256	6,422	7,826	9,135
Extraordinary items	29,182	(580)	0	0	0
Min. int./Inc. from assoc.	543	302	0	0	0
<b>Reported net profit</b>	<b>53,351</b>	<b>26,482</b>	<b>21,498</b>	<b>26,201</b>	<b>30,581</b>
Adjustments	(29,182)	580	0	0	0
<b>Adjusted net profit</b>	<b>24,170</b>	<b>27,062</b>	<b>21,498</b>	<b>26,201</b>	<b>30,581</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	27,947	27,030	30,089	31,904	33,839
Other current liabilities	29,831	30,400	29,287	31,053	32,936
Provisions	3,291	3,424	3,562	3,777	4,006
Debt funds	52,373	28,513	22,810	19,959	15,967
Other liabilities	0	0	0	0	0
Equity capital	586	586	586	586	586
Reserves & surplus	2,19,923	2,46,378	2,64,966	2,88,238	3,15,890
Shareholders' fund	2,20,509	2,46,964	2,65,552	2,88,824	3,16,476
<b>Total liab. and equities</b>	<b>3,33,950</b>	<b>3,36,331</b>	<b>3,51,301</b>	<b>3,75,517</b>	<b>4,03,224</b>
Cash and cash eq.	54,680	41,900	58,854	76,577	95,024
Accounts receivables	35,033	40,123	40,119	42,539	45,118
Inventories	90,266	75,539	76,895	77,988	82,717
Other current assets	23,711	26,006	19,769	20,961	22,232
Investments	5,910	9,972	9,972	9,972	9,972
Net fixed assets	68,866	77,284	80,184	81,973	82,652
CWIP	30,615	37,472	37,472	37,472	37,472
Intangible assets	24,870	28,036	28,036	28,036	28,036
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>3,33,950</b>	<b>3,36,331</b>	<b>3,51,301</b>	<b>3,75,517</b>	<b>4,03,224</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
<b>Cash flow from operations</b>	<b>55,282</b>	<b>45,361</b>	<b>40,756</b>	<b>38,644</b>	<b>40,441</b>
Capital expenditures	(14,000)	(14,800)	(14,800)	(14,800)	(14,800)
Change in investments	(363)	(4,061)	0	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(14,363)</b>	<b>(18,861)</b>	<b>(14,800)</b>	<b>(14,800)</b>	<b>(14,800)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(4,494)	(23,860)	(5,703)	(2,851)	(3,992)
Interest expenses	(745)	(486)	(389)	(340)	(272)
Dividends paid	(2,930)	(2,930)	(2,930)	(2,930)	(2,930)
Other financing cash flows	(6,492)	(12,003)	19	0	0
<b>Cash flow from financing</b>	<b>(14,660)</b>	<b>(39,279)</b>	<b>(9,002)</b>	<b>(6,121)</b>	<b>(7,194)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>26,258</b>	<b>(12,780)</b>	<b>16,954</b>	<b>17,722</b>	<b>18,448</b>
<b>Closing cash &amp; cash eq.</b>	<b>54,680</b>	<b>41,900</b>	<b>58,854</b>	<b>76,577</b>	<b>95,024</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	91.1	45.2	36.7	44.7	52.2
Adjusted EPS	41.3	46.2	36.7	44.7	52.2
Dividend per share	2.5	2.5	2.5	2.5	2.5
Book value per share	376.8	422.0	453.8	493.5	540.8

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	1.3	1.2	1.1	1.0	0.8
EV/EBITDA	5.9	6.6	7.0	5.7	4.6
Adjusted P/E	11.4	10.2	12.8	10.5	9.0
P/BV	1.2	1.1	1.0	0.9	0.9

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	53.9	78.2	77.0	77.0	77.0
Interest burden (PBT/EBIT)	104.7	106.2	106.5	109.3	111.0
EBIT margin (EBIT/Revenue)	17.3	13.9	10.7	12.0	13.0
Asset turnover (Rev./Avg TA)	24.8	21.4	21.6	21.7	21.4
Leverage (Avg TA/Avg Equity)	1.3	1.2	1.1	1.1	1.1
Adjusted ROAE	12.4	11.6	8.4	9.5	10.1

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	7.3	(5.3)	4.1	6.0	6.1
EBITDA	10.5	(17.8)	(13.1)	15.8	13.0
Adjusted EPS	(15.8)	12.0	(20.6)	21.9	16.7
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	21.5	18.7	15.6	17.1	18.2
EBIT margin	17.3	13.9	10.7	12.0	13.0
Adjusted profit margin	9.8	11.5	8.8	10.1	11.1
Adjusted ROAE	12.4	11.6	8.4	9.5	10.1
ROCE	18.2	12.8	10.0	11.5	12.5
<b>Working capital days (days)</b>					
Receivables	52	62	60	60	60
Inventory	133	118	115	110	110
Payables	41	42	45	45	45
<b>Ratios (x)</b>					
Gross asset turnover	1.8	1.6	1.5	1.4	1.4
Current ratio	3.3	3.0	3.1	3.3	3.5
Net interest coverage ratio	57.4	67.0	67.4	91.4	131.3
Adjusted debt/equity	0.0	(0.1)	(0.1)	(0.2)	(0.2)

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

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

**BUY** – Expected return >+15%

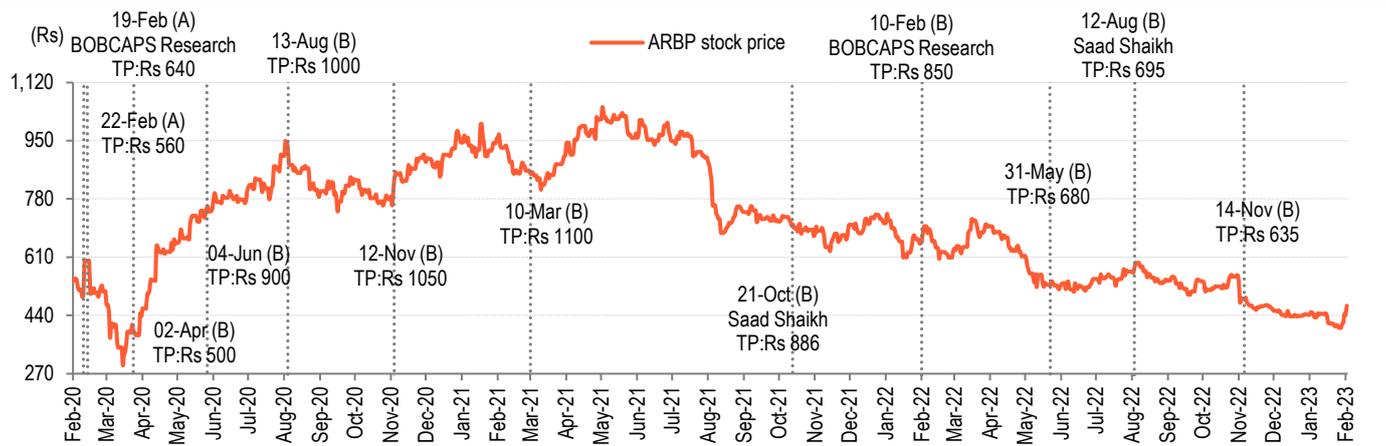
**HOLD** – Expected return from -6% to +15%

**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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