

BUY

TP: Rs 900 | ▲ 19%

AUROBINDO PHARMA

Pharmaceuticals

04 June 2020

Strong Q4; upside risk to EPS can support higher multiple

Revenue/EBITDA beat estimates by 2%/9% led by strong sales (ex-US) and gross margin expansion. Injectable sales fell QoQ but should recover Q1 onwards. Net debt has reduced further by US\$ 84mn (~US\$ 350mn in FY20). Management sees limited impact from Covid-19 in FY21 and believes overall US momentum and gross margins of 58-59% would sustain. FDA inspection of Unit 7 and Eugia are key near-term events. We increase FY21/FY22 EPS by 11-17%. Retain BUY with a revised Mar'21 TP of Rs 900 based on 10x EV/EBITDA (7x earlier).

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Strong sales ex-US, sharp uptick in gross margins – key positives: While headline US sales were in line at US\$ 415mn (flat QoQ), adjusting for lower injectable sales, oral solid dosage business increased 4-5% driven by baseline products. EU and EM (up 26-30% YoY) were a beat partly due to pre-buying. EBITDA margin expanded to 21.8% as gross margin stood strong at 59%, up 285bps QoQ (product mix, forex benefit, lower RM cost). Injectable sales fell 21% QoQ to US\$ 59mn due to fewer surgeries and Ertapenem competition.

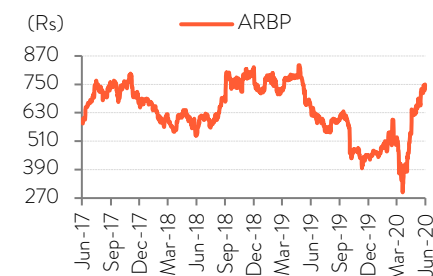
Outlook intact: US sales should see decent growth in FY21 led by volume uptick in existing products and 50 (incl. injectable) launches excluding affected units. Next 2-3 years, company expect 50 filings annually with Gross margin of 58-59% in FY21. Net debt-free target revised to FY22 (from FY23). Demerged Biologics entity should start reflecting revenues from FY22. CAPA for Unit 7 was submitted yesterday and expect desktop reviews for Units 1, 9 and 11.

Premium sustainable – BUY: Stock valuation has expanded ~50% in last 2 months after Sandoz deal called-off (see our Apr'20 [Upgrade to BUY](#) report) and is now trading at 9x FY21E EBITDA (5Y band of 5-12x), ~20% above global peers. Strong US pipeline execution, wider portfolio and nimble supply chain can drive further upsides to our EPS, supporting a higher valuation multiple in the medium term.

Ticker/Price	ARBP IN/Rs 759
Market cap	US\$ 5.9bn
Shares o/s	586mn
3M ADV	US\$ 63.2mn
52wk high/low	Rs 791/Rs 289
Promoter/FPI/DII	52%/19%/15%

Source: NSE

STOCK PERFORMANCE



KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	164,630	195,634	230,986	247,942	258,193
EBITDA (Rs mn)	37,718	39,519	48,640	50,916	53,049
Adj. net profit (Rs mn)	24,227	24,126	28,911	29,966	31,173
Adj. EPS (Rs)	41.3	41.2	49.3	51.1	53.2
Adj. EPS growth (%)	5.3	(0.4)	19.8	3.7	4.0
Adj. ROAE (%)	23.1	18.8	18.7	16.4	14.8
Adj. P/E (x)	18.4	18.4	15.4	14.8	14.3
EV/EBITDA (x)	12.7	12.1	10.0	9.5	8.8

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	Q4FY20E	Var (%)	FY20P	FY19	YoY (%)
Net Sales	61,584	52,921	16.4	58,949	4.5	60,619	1.6	230,984	195,634	18.1
EBITDA	13,425	10,603	26.6	12,080	11.1	12,366	8.6	48,645	39,522	23.1
Depreciation	2,324	1,866	-	2,501	-	2,501	-	9,666	6,678	-
EBIT	11,101	8,737	27.1	9,579	15.9	9,865	-	38,979	32,844	18.7
Interest	318	500	-	371	-	400	-	1,597	1,625	-
Other Income	326	323	-	220	-	220	-	862	1,157	-
PBT	11,109	8,560	29.8	9,428	17.8	9,685	14.7	38,244	32,376	18.1
Less: Taxation	2,285	2,311	-	2,328	-	2,421	-	9,134	7,267	-
Less: Minority Interest	193	0	-	0	-	0	-	193	(22)	-
Recurring PAT	8,631	6,249	38.1	7,100	21.6	7,264	18.8	28,917	25,131	15.1
Exceptional items	(140)	(384)	-	(40)	-	0	-	(705)	(1,483)	-
Reported PAT	8,491	5,865	44.8	7,060	20.3	7,264	16.9	28,212	23,647	19.3
Key Ratios (%)										
Gross Margin	59.4	55.2	-	56.5	-	56.4	-	57.9	55.5	-
EBITDA Margin	21.8	20.0	-	20.5	-	20.4	-	21.1	20.2	-
Tax / PBT	20.6	27.0	-	24.7	-	25.0	-	23.9	22.4	-
NPM	14.0	11.8	-	12.0	-	12.0	-	12.5	12.8	-
EPS (Rs)	14.7	10.7	-	12.1	-	12.4	-	49.4	42.9	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	Q4FY20E	Var (%)	FY20P	FY19	YoY (%)
Formulations	54,012	43,734	23.5	51,050	5.8	51,241	5.4	200,120	161,568	23.9
US	29,903	24,810	20.5	29,694	0.7	29,880	0.1	114,836	90,306	27.2
Europe	16,525	13,118	26.0	14,763	11.9	15,118	9.3	59,217	49,602	19.4
EM	3,766	2,891	30.3	3,459	8.9	2,949	27.7	13,551	11,936	13.5
ARV	3,818	2,915	31.0	3,134	21.8	3,294	15.9	12,516	9,724	28.7
APIs	7,556	9,167	(17.6)	7,898	(4.3)	9,375	(19.4)	30,834	34,031	(9.4)
Net Sales	61,585	52,921	16.4	58,951	4.5	60,619	1.6	230,954	195,599	18.1

Source: Company, BOBCAPS Research

Valuation methodology

Three sites will be critical to drive growth for Aurobindo Pharma (ARBP) in the coming years, i.e. Units 4, 10 and Eugia. Together these account for ~75% of the company's pending ANDAs. While Unit 4 and Unit 10 were cleared recently by the USFDA, we expect Eugia to be inspected any time now (21 pending ANDAs accounting for 14% of pending files). We assume a low probability of any significant impact from the recent Aurolife unit OAI classification, given limited pending approvals (~5% to total pending ANDAs) and low contribution to US business (~2% to total sales).

We increase FY21/FY22 EPS by 11-17% driven by US sales revision, ~100bps higher margin assumptions, INR/US\$ reset to Rs 74 and reduction in interest cost. The stock has moved up sharply by ~50% in the last two months and is now trading at 9x FY21E EBITDA (vs. the five-year historical band of 5-12x), which is ~20% higher than global peers Teva, Endo, Mylan and Perrigo. The rerating is in line with our expectations, as highlighted in our [Apr'20 report](#), due to favourable risk-reward, substantial reduction in leverage and resilient operating results. While the outlook appears steady amidst Covid-19-led macro challenges, we see limited scope for further multiple expansion though upside risk to our FY21/FY22 EPS estimates remains.

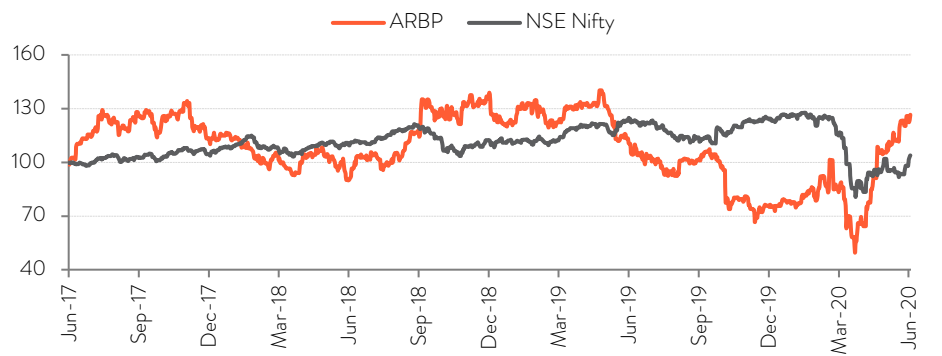
We retain BUY with a revised Mar'21 target price of Rs 900 (from Rs 500), based on ~10x EV/EBITDA vs. 7x earlier. The increase in target multiple reflects a continued ~30% discount to other frontline stocks (Cipla, Dr Reddy's, Lupin) due to low branded sales and high US exposure. Key downside risks are penalty risk from Aceto supply-chain sabotage claim (in the US District Court).

FIG 3 – REVISED ESTIMATES

(Rs bn)	New			Old			Change (%)		
	FY20P	FY21E	FY22E	FY20P	FY21E	FY22E	FY20P	FY21E	FY22E
Sales	231	248	258	231	238	248	0.1	4.0	4.1
EBITDA	49	51	53	47	47	49	3.2	9.1	9.3
EBITDA margin (%)	21.1	20.5	20.5	20.4	19.6	19.6	65bps	97bps	98bps
EPS (Rs)	49	51.1	53.2	46.6	43.7	47.9	5.8	17.0	11.1

Source: Company, BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **US approval delays:** The US forms the single largest delta in our operating profit estimates for FY21-FY22 (>60% of profit); hence, delays in key approvals and execution hurdles are key 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 EPS estimates.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue	164,630	195,634	230,986	247,942	258,193
EBITDA	37,718	39,519	48,640	50,916	53,049
Depreciation	5,580	6,680	9,667	11,005	11,478
EBIT	32,138	32,839	38,973	39,911	41,571
Net interest income/(expenses)	(777)	(2,626)	(1,597)	(1,450)	(1,115)
Other income/(expenses)	1,020	1,157	862	1,495	1,109
Exceptional items	0	0	0	0	0
EBT	32,381	31,370	38,238	39,955	41,564
Income taxes	8,183	7,268	9,134	9,989	10,391
Extraordinary items	0	(483)	(705)	0	0
Min. int./Inc. from associates	(29)	(25)	193	0	0
Reported net profit	24,227	23,642	28,206	29,966	31,173
Adjustments	0	483	705	0	0
Adjusted net profit	24,227	24,126	28,911	29,966	31,173

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Accounts payables	26,274	26,771	25,450	33,965	35,369
Other current liabilities	15,324	24,390	30,745	29,753	30,983
Provisions	2,567	2,273	4,914	5,274	5,492
Debt funds	47,710	69,668	56,867	39,807	15,923
Other liabilities	0	0	0	0	0
Equity capital	586	586	586	586	586
Reserves & surplus	117,001	138,686	168,912	195,947	224,191
Shareholders' fund	117,587	139,272	169,498	196,533	224,777
Total liabilities and equities	209,462	262,373	287,473	305,332	312,544
Cash and cash eq.	12,616	19,594	28,421	21,397	22,944
Accounts receivables	38,788	47,771	43,552	61,136	63,664
Inventories	58,584	72,456	76,999	78,119	77,812
Other current assets	15,324	17,518	19,130	22,315	23,237
Investments	3,115	3,602	5,547	5,547	5,547
Net fixed assets	47,365	56,936	64,948	67,943	70,465
CWIP	15,829	16,685	19,859	19,859	19,859
Intangible assets	17,841	27,811	29,017	29,017	29,017
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	209,462	262,373	287,474	305,332	312,544

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net income + Depreciation	29,807	30,322	37,873	40,972	42,651
Interest expenses	777	2,626	1,597	1,450	1,115
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(12,847)	(15,780)	5,738	(14,005)	(291)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	17,737	17,168	45,208	28,417	43,475
Capital expenditures	(22,593)	(26,028)	(17,500)	(14,000)	(14,000)
Change in investments	(657)	(487)	(1,945)	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(23,250)	(26,515)	(19,445)	(14,000)	(14,000)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	14,069	21,958	(12,800)	(17,060)	(23,884)
Interest expenses	(777)	(2,626)	(1,597)	(1,450)	(1,115)
Dividends paid	(2,641)	(2,930)	(2,930)	(2,930)	(2,930)
Other financing cash flows	2,344	(77)	391	(1)	0
Cash flow from financing	12,995	16,325	(16,937)	(21,441)	(27,928)
Changes in cash and cash eq.	7,482	6,978	8,827	(7,024)	1,547
Closing cash and cash eq.	12,616	19,594	28,421	21,397	22,944

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
Reported EPS	41.3	40.4	48.1	51.1	53.2
Adjusted EPS	41.3	41.2	49.3	51.1	53.2
Dividend per share	2.5	2.5	2.5	2.5	2.5
Book value per share	200.9	238.0	289.6	335.8	384.1

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
EV/Sales	2.9	2.4	2.1	2.0	1.8
EV/EBITDA	12.7	12.1	10.0	9.5	8.8
Adjusted P/E	18.4	18.4	15.4	14.8	14.3
P/BV	3.8	3.2	2.6	2.3	2.0

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Tax burden (Net profit/PBT)	74.8	76.9	75.6	75.0	75.0
Interest burden (PBT/EBIT)	100.8	95.5	98.1	100.1	100.0
EBIT margin (EBIT/Revenue)	19.5	16.8	16.9	16.1	16.1
Asset turnover (Revenue/Avg TA)	28.2	26.1	26.5	26.8	27.1
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.4	1.3	1.1
Adjusted ROAE	23.1	18.8	18.7	16.4	14.8

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
YoY growth (%)					
Revenue	10.4	18.8	18.1	7.3	4.1
EBITDA	9.8	4.8	23.1	4.7	4.2
Adjusted EPS	5.3	(0.4)	19.8	3.7	4.0
Profitability & Return ratios (%)					
EBITDA margin	22.9	20.2	21.1	20.5	20.5
EBIT margin	19.5	16.8	16.9	16.1	16.1
Adjusted profit margin	14.7	12.3	12.5	12.1	12.1
Adjusted ROAE	23.1	18.8	18.7	16.4	14.8
ROCE	22.8	18.2	18.3	17.9	17.9
Working capital days (days)					
Receivables	86	89	69	90	90
Inventory	130	135	122	115	110
Payables	58	50	40	50	50
Ratios (x)					
Gross asset turnover	2.1	1.9	1.9	1.8	1.7
Current ratio	2.8	2.9	2.8	2.7	2.6
Net interest coverage ratio	41.4	12.5	24.4	27.5	37.3
Adjusted debt/equity	0.3	0.4	0.2	0.1	0.0

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

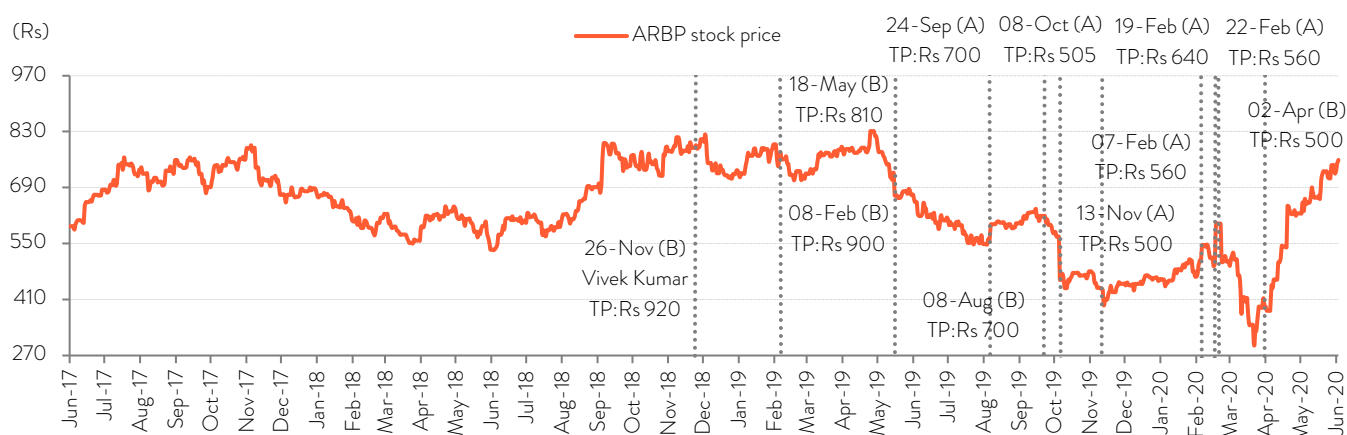
ADD – Expected return from >+5% to +15%

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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