

RESEARCH
BOB Economics Research | Weekly Wrap

Global activity dips in Sep'19

Aurobindo Pharma | Target: Rs 505 | +10% | ADD

Form 483 for Unit 7: Warning letter risk largely priced in

SUMMARY
India Economics: Weekly Wrap

Global economy has slowed down further in Sep'19 with US ISM manufacturing index at a 10-year low. Yields fell across major economies led by US. Crude oil too fell by (-) 5.7% in the week. Global equity markets also declined, led by FTSE (Brexit), Dax and then Sensex. RBI responded to a slowing domestic economy with a 25bps rate cut and an assurance to be accommodative. While short-end yields fell, curve steepened further due to uncertainty over fiscal deficit and thus the borrowing in H2.

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Aurobindo Pharma

ARBP's stock corrected 20% on 7th Oct following 483 details on Unit 7 (oral formulation unit). The unit was inspected from 19-27 Sep and received 7 observations. The inspectors were Tamil Arasu, Jogy George and Emmanuel J. Ramos. 483s cites quality issues which could delay new product approvals. This could be a near-term overhang until EIR is received. However, Stock at 10x FY21 P/E pose better risk/reward (40% dis. to peers). FDA inspection for critical units are now over. Retain ADD & revise PT to Rs505 (from Rs 700).

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TOP PICKS
LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	555
GAIL	Buy	200
HPCL	Buy	400
ONGC	Buy	200
TCS	Add	2,360

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,230
Future Supply	Buy	730
Greenply Industries	Buy	200
Laurus Labs	Buy	480
PNC Infratech	Buy	250

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.53	(1bps)	7bps	(170bps)
India 10Y yield (%)	6.69	8bps	17bps	(134bps)
USD/INR	70.88	0	2.1	3.9
Brent Crude (US\$/bbl)	58.37	1.1	0.2	(30.6)
Dow	26,574	1.4	1.7	0.5
Shanghai	2,905	(0.9)	(0.9)	3.0
Sensex	37,673	(1.1)	3.0	9.6
India FII (US\$ mn)	3 Oct	MTD	CYTD	FYTD
FII-D	103.8	334.0	4,581.1	4,036.5
FII-E	(57.8)	(670.8)	6,535.3	(309.9)

Source: Bank of Baroda Economics Research

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WEEKLY WRAP

07 October 2019

Global activity dips in Sep'19

Global economy has slowed down further in Sep'19 with US ISM manufacturing index at a 10-year low. Yields fell across major economies led by US. Crude oil too fell by (-) 5.7% in the week. Global equity markets also declined, led by FTSE (Brexit), Dax and then Sensex. RBI responded to a slowing domestic economy with a 25bps rate cut and an assurance to be accommodative. While short-end yields fell, curve steepened further due to uncertainty over fiscal deficit and thus the borrowing in H2.

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Markets

- **Bonds:** Apart from Japan, global yields closed lower over concerns of slowing global growth. PMI readings across regions indicate both manufacturing and services activity is seen to be moderating. China's exports shrank for 15th month in a row. US 10Y yield fell by 15bps (1.53%) and crude prices dropped by (-) 5.7% (US\$ 58/bbl). India's 10Y yield fell by only 5bps (6.7%) even after 25bps rate cut by RBI as concerns over fiscal deficit remain. System liquidity was in surplus of Rs 2.5tn as on 04 Oct 2019 vs Rs 1.6tn in the previous week.
- **Currency:** Barring CNY and INR, other global currencies closed higher in the week. DXY fell by (-) 0.3% as US macro data disappointed (ISM manufacturing and non-manufacturing PMI). JPY rose by 0.9% on safe-haven demand on heightened fears over global growth. GBP fell by (-) 1.5% as uncertainty over Brexit intensified. INR fell by (-) 0.5% on the back of FII outflows (US\$ 553mn) even as oil prices declined by (-) 5.7%.
- **Equity:** Stoked by fears of slowdown in US and uncertainty surrounding Brexit, global indices ended in red this week. FTSE (-3.6%) was the worst performer. This was followed by Dax and Sensex, each falling by (-) 3%. Equity markets are preparing for a slowing economy across regions. RBI lowered FY20 growth projection to 6.1%. Financials and metal stocks fell the most.
- **Upcoming key events:** In the current week, markets will keenly await US FOMC minutes, US CPI and PPI print. In addition, industrial production data for UK, Germany, and France is also scheduled for release. On the domestic front, industrial production data will be released this week.



ADD

TP: Rs 505 | ▲ 10%

AUROBINDO PHARMA

Pharmaceuticals

08 October 2019

Form 483 for Unit 7: Warning letter risk largely priced in

ARBP's stock corrected 20% on 7th Oct following 483 details on Unit 7 (oral formulation unit). The unit was inspected from 19-27 Sep and received 7 observations. The inspectors were Tamil Arasu, Jogy George and Emmanuel J. Ramos. 483s cites quality issues which could delay new product approvals. This could be a near-term overhang until EIR is received. However, Stock at 10x FY21 P/E pose better risk/reward (40% dis. to peers). FDA inspection for critical units are now over. Retain ADD & revise PT to Rs505 (from Rs 700).

Vivek Kumar

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Implication: Unit 7 is an important plant as it accounts for ~US\$300mn in current US sales and ~8% of the total FY21 sales. It has 20 pending approvals (15% of total pending files). This should hurt near-term growth outlook. In the worst case (warning letter) we see additional 5% EPS cut on our revised FY21e if the EIR gets delayed beyond 12 months.

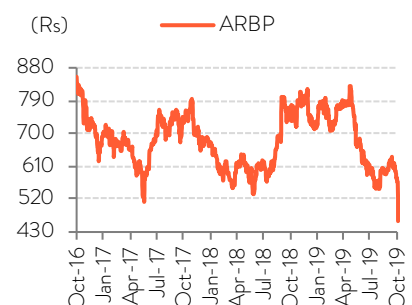
Observation #1 & #5 are key: These are related to lack of scientifically sound process to identify root cause for OOS results, quality control, inadequate data files. These would require more check, review of the quality/process control, training/documentation & new SOPs in few cases ([details inside](#)). The US FDA previously inspected the Unit 7 in June'17 and was issued zero observations.

Retain ADD but expect another 10% downside in stock at worst: We expect likely escalation of Unit 7/483's to a warning letter given quality control lapses but largely priced in our view. We don't see any data integrity issue. Resolution could take at least 5 months meaning delay in approvals and 20-25% utilization hit. Stock post sharp fall offer better risk-reward trading at 10x FY21 EPS (40% discount to peers). Inspection for key dosage units are now over (3, 4, 7, 10, Eugia). We cut EPS /target multiple by 9%/16% and revise PT to Rs 505.

Ticker/Price	ARBP IN/Rs 460
Market cap	US\$ 3.8bn
Shares o/s	586mn
3M ADV	US\$ 23.0mn
52wk high/low	Rs 838/Rs 450
Promoter/FPI/DII	52%/19%/15%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	164,630	195,634	231,311	277,291	284,116
EBITDA (Rs mn)	37,718	39,519	47,842	52,912	53,631
Adj. net profit (Rs mn)	24,227	24,126	27,071	27,276	27,397
Adj. EPS (Rs)	41.3	41.2	46.2	46.6	46.8
Adj. EPS growth (%)	5.3	(0.4)	12.2	0.8	0.4
Adj. ROAE (%)	23.1	18.8	17.9	15.5	13.7
Adj. P/E (x)	11.1	11.2	10.0	9.9	9.8
EV/EBITDA (x)	7.9	7.7	6.7	7.1	6.7

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)

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