

Aurobindo Pharma

BSE SENSEX

29,926

S&P CNX

9,314



Stock Info

Bloomberg	ARBP IN
Equity Shares (m)	586
52-Week Range (INR)	895 / 582
1, 6, 12 Rel. Per (%)	-10/-31/-44
M.Cap. (INR b)	390.8
M.Cap. (USD b)	6.0
Avg Val, INRm	1605
Free float (%)	48.1

Financials Snapshot (INR b)

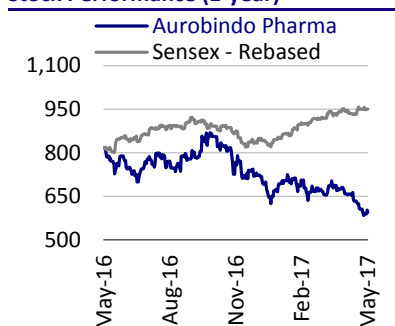
Y/E Mar	2017E	2018E	2019E
Net Sales	151.7	174.9	199.3
EBITDA	35.8	41.8	48.8
PAT	23.3	26.6	31.8
EPS (INR)	39.8	45.4	54.3
Gr. (%)	17.5	14.1	19.7
BV/Sh (INR)	157.9	200.8	252.6
RoE (%)	28.6	25.3	24.0
RoCE (%)	19.5	19.4	19.5
P/E (x)	15.0	13.1	11.0
P/BV (x)	3.8	3.0	2.4

Shareholding pattern (%)

As On	Mar-17	Dec-16	Mar-16
Promoter	51.9	51.9	53.8
DII	12.8	11.0	7.3
FII	21.0	24.1	27.4
Others	14.4	13.0	11.5

FII Includes depository receipts

Stock Performance (1-year)


CMP: INR596
TP: INR900 (+51%)
Buy

Unit 4 observations out: Risk of warning letter minimal

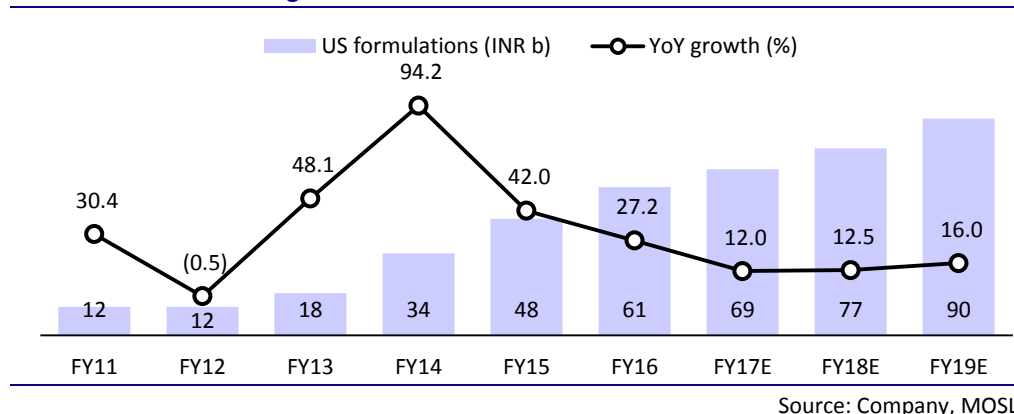
- **Approvals from Unit 4 may get delayed by six months:** Aurobindo's Unit 4 facility was inspected by the USFDA in April 2017. The observation letter is out – although there are no data integrity issues, remediation requires infra repair, change in equipment, training, etc. We do not see a risk of warning letter, but believe that approvals from this facility may get delayed by six months.
- **Key injectables facility:** Injectables sales to the US are estimated at ~USD150m in FY17, of which this plant would account for ~USD100-110m (4.5% of sales). This plant accounts for about 35 of the 40 total pending injectables ANDAs.
- **Impact of delay in approvals already priced in:** For FY18E, we had built in US sales of ~USD225m from injectables (v/s USD150m in FY17E). Assuming six months of delay in approvals from Unit 4, sales loss would be USD45m @ 35% EBITDA margins (v/s consol. margins of ~23.5%). In worst case, the impact of delayed approvals on FY18 PAT will be ~2.5%.
- **Unit 3 facility out of woods:** On 5 May 2017, ARBP received ANDA approval for Lamivudine and Zidovudine oral tablets from the Unit-3 oral formulations facility (~USD200m sales; ~20% of US sales; 8.5% of total sales). This plant was inspected in April 2017 and received six 483 observations, all of which were procedural in nature ([click here to access our detailed report on this](#)). This puts to rest concerns about any negative outcome from this facility.
- **Lower tax rate in US bodes well; risk mitigation strategy in place for border tax:** The US government has proposed to lower the corporate tax rate from 35% to 15%. The company's US subsidiaries generated PBT of INR5b in FY16 and paid tax @32% of PBT. If the tax rate in the US comes down to 15%, then ARBP will save >INR1b in FY17/18E (EPS of ~INR1.8-2). On the other hand, border tax adjustment is a key overhang to the generic suppliers. We believe ARBP can mitigate this risk partially by expanding its Auro Life facility (can go 3x by doing brownfield expansion).
- **Pricing risk lowest among peers:** No single product for ARBP contributes more than 3% of sales (unlike SUNP, LPC and DRRD, where the top three products account for >20-25% of sales). Also, no single ANDA has any meaningful disproportionate contribution to margins, as ARBP has a matured product basket with all ~190 launched ANDAs facing competition from multiple players (typically 4-5 or more).
- **R&D expense to remain range bound in near term:** We expect ARBP to file 35-40 ANDAs in FY18E (including 6-7 controlled substance, 10-15 oncology & hormones, etc.). Oncology & hormones-related R&D expense will be borne by the Eugia JV, and will not be part of R&D expense for ARBP. We expect R&D expense for the company to not inch up beyond 5.5% in FY18E and 7% in FY19E. Impact of this increase in expense will get offset by ~50% growth in the high-margin injectables business.
- **Valuation gap to narrow:** At CMP, ARBP trades at ~15x FY17E, which is at >25% discount to peers. Valuation gap should narrow on account of the company's increasing profitability, strong earnings growth trajectory (17% CAGR until FY19E) and improving free cash flow. ARBP remains one of our top picks in the sector. Assuming the impact of delay in approvals, our FY18 EPS estimate will come down by ~2.5%. We maintain our TP of INR900@ 18x 1HFY19E PER.

US business – strong growth to sustain

US business to record mid-teens CAGR

Over FY11-16, ARBP delivered robust >50% CAGR, driven by niche oral launches (including Cymbalta) and entry into injectables, controlled substances and government tender business. Despite strong growth over the last five years, we believe ARBP is well poised to outpace peers in the coming years. We expect ARBP to deliver mid-teens growth in the US on the back of a strong launch pipeline in injectables (~40 pending ANDAs), steady mid-teens growth in Natrol and huge capacity expansion in orals and injectables (which will lead to volume push in existing and new products). We expect a pick-up in US sales over the coming quarters led by key launches, including Epzicom, Meropenem, Tenofovir, Toprol XL and Fortamet, Solu-Medrol. Apart from this, ARBP has an approved pipeline of ~50 products (~13 OTCs, 5-6 OTCs, 6 injectables, rest orals including Vancomycin), which are expected to be launched in 2QFY18.

Exhibit 1: US business to grow at ~14%YoY



Lower tax rate in US bodes well; risk mitigation strategy in place for border tax

The US government has proposed to lower the corporate tax rate from 35% to 15%. The company's US subsidiaries generated PBT of INR5b in FY16 and paid tax @32% of PBT. If the tax rate in the US comes down to 15%, then ARBP will save >INR1b in FY17/18E (EPS of ~INR1.8-2). On the other hand, border tax adjustment is a key overhang to the generic suppliers. We believe ARBP can mitigate this risk partially by expanding its Auro Life facility (can go 3x by doing brownfield expansion).

Exhibit 2: US subsidiaries' contribution to ARBP

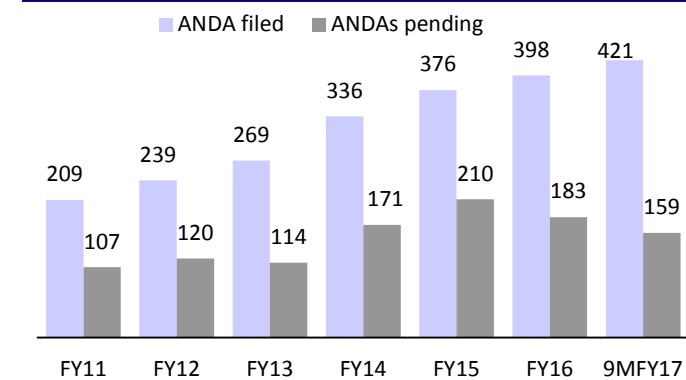
Name of the Subsidiary	Sales	PBT	Tax	PAT
Aurobindo Pharma USA Inc	34,945.50	1,080.60	350.3	730.3
Aurolife Pharma LLC	9,215.80	2,605.30	844.6	1,760.70
Auromedics Pharma LLC	6,305.00	406.5	131.8	274.7
Auro Health LLC	259.4	-220.8	-71.6	-149.2
Natrol Inc	7,367.80	1,122.90	364	758.8
Total US subsidiaries	58,093.50	4,994.50	1,619.10	3,375.30
Consolidated ARBP	138,960.80	27,224.70	7443.7	19,820.10
US as % of ARBP	41.8%	18.3%	21.8%	17.0%

Source: Company, MOSL

Burst of approvals provides strong visibility of future growth

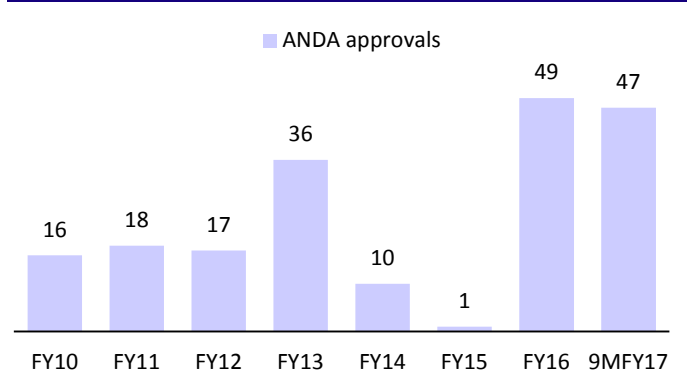
ARBP received 49 and 47 ANDA approvals in FY16 and 9MFY17, respectively (highest in the industry). The approvals are a mix of plain vanilla generics, limited competition injectables and complex oral generics. Out of the pending injectables portfolio of ~40 ANDAs, most were filed 12-24 months back. We thus expect multiple injectables approvals to come through over the next two years.

Exhibit 3: Robust ANDA pipeline



Source: Company, MOSL

Exhibit 4: Highest number of approvals amongst peers

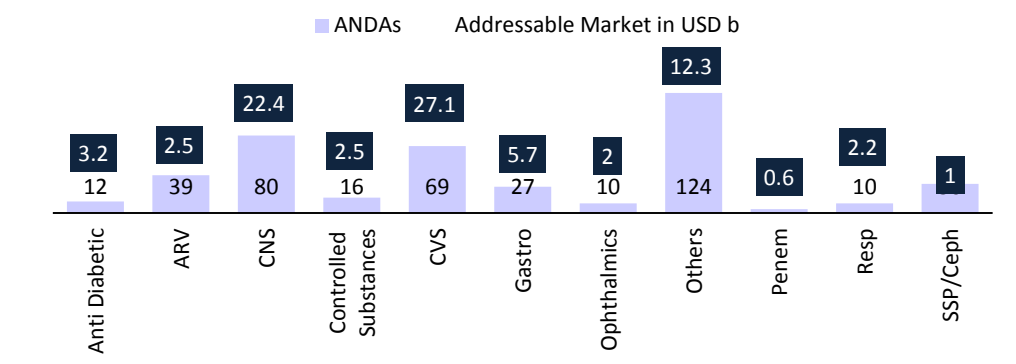


Source: Company, MOSL

Exhibit 5: Unit-wise ANDA filings as on 31-Dec-2016

Unit	Details	Final Approval		Tentative Approval		Under Review		Total	
		Mar-16	Dec-16	Mar-16	Dec-16	Mar-16	Dec-16	Mar-16	Dec-16
III	Oral Formulations	93	99	19	16	12	10	124	125
IV	Inj & Ophthalmics	28	38	2	2	37	35	67	75
VI B	Ceph Oral	11	11					11	11
VII (SEZ)	Oral Formulations	54	79	15	23	79	56	148	158
X	Oral Formulations						2		2
XII	Penicillin Oral & Inj	19	19				1	19	20
Auro Life USA	Oral Formulations	10	16			16	10	26	26
Auronext	Penem Inj					3	4	3	4
Total		215	262	36	41	147	118	398	421

Exhibit 6: Expanding portfolio mix toward high-value products



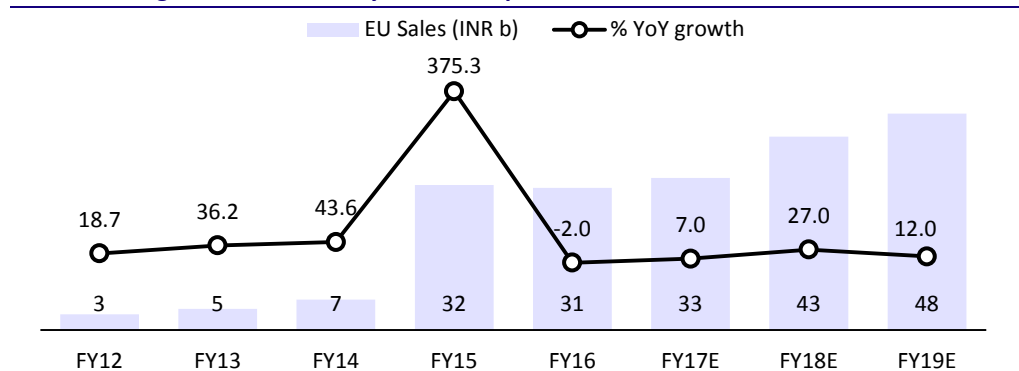
Source: Company, MOSL

European operations – Commencement of Vizag facility to lead to margin expansion

ARBP has expanded its Europe business inorganically. Till date, it has acquired 5-6 businesses in Europe (Milopharm in 2006, Pharmacin in 2007, Actavis in 2014, Generis & Teva businesses in 2016). After these acquisitions, ARBP has become one of the top 10 players in EU. Supplies from the Vizag plant to Europe will start from March-17. This will have a two-pronged impact: 1) capacity at Unit VII and Unit III will get released (which are primarily used for supply to the US and are running at capacity utilization of ~80%) and 2) European business margins should expand (to ~7-8% in FY18E from ~5% currently) as the company plans to manufacture 50% of products sold in EU at this plant.

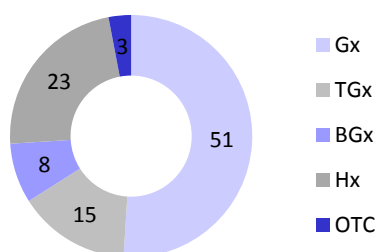
Currently, manufacturing of ~60 products has been shifted to India (to Unit VII & III). Given that supply from Vizag to EU markets will start from Mar-17, the company plans to shift manufacturing of ~114 products from Vizag (sales value of >USD200m) over next 12-18 months. This will lead to significant cost savings. We expect EBITDA margins of this business to expand from ~5% currently to ~7-8% in FY18 and low-double-digits in FY19.

Exhibit 7: EU growth bolstered by Actavis acquisition



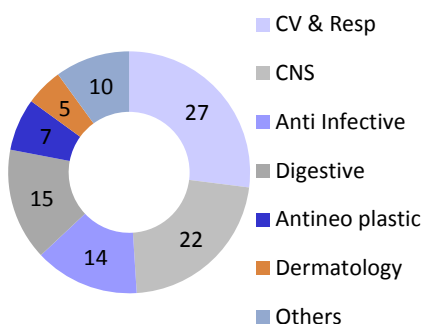
Source: Company, MOSL

Exhibit 8: Sales split by Channel



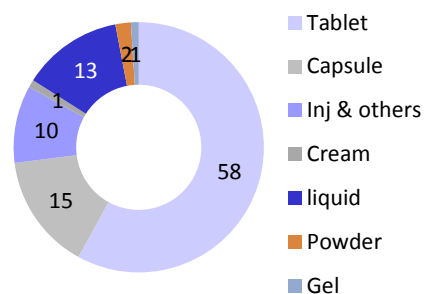
Source: Company, MOSL

Exhibit 9: Sales split by Therapeutic Profile



Source: Company, MOSL

Exhibit 10: Sales split by Dosage Forms



Source: Company, MOSL

Exhibit 11: EU: Portfolio mix across channels

Channels	Gx	BGx	Hx	TGx
Geographies	All 9 countries	7 countries	All 9 countries	Germany, Spain & Netherlands
# of Products	761 (Primarily tablets & capsules)	34	343 (predominantly Inj)	765 (Including Gx products)
Other Highlights	Amongst top 10 in most markets	Includes leading brands such as Neotigason, Floxapen, Bezalip among others	Focus on high value areas including oncology	Tender based business

Portugal acquisition to provide market leadership: With Generis acquisition (announced in Jan-17), ARBP gets a well-diversified portfolio (primarily in the area of Cardio – 26% of sales, CNS – 22% and anti-infectives – 13%), addressing 95% of the generic retail market by value with 227 products + 51 products awaiting approval. Post completion of this acquisition, ARBP will become number 1 player in the Portugal market and among the top 10 generic companies in EU (from no. 13 earlier). Portugal's pharma market size stands at EUR3.4b, with generic penetration in volume at ~30%, significantly below EU average of ~53% and US average of ~80%.

Estimated sales of Generis stood at EUR64.8m in CY16 (largely remained flat over last three years), with EBITDA of EUR12.7m (EBITDA margin of ~19.6% v/s ARBP's EU biz margin of mid-single-digits). ARBP expects sales growth of >12% in CY17 with improved EBITDA margin of 21.7%. Improvement in profitability is expected on the back of new launches and resolution of temporary supply chain issues from third party in 2016.

ARBP expects synergy benefits of EUR2m and EUR5m in 2018 and 2019, respectively (and expected to improve further). This will be primarily driven by new product portfolio launch, market leadership status and improvement in capacity utilization.

With this acquisition, ARBP will have its first formulations plant in EU (with capacity of 1.2b tablets/ capsules/ sachets). Existing plant capacity is at ~50%, which provides ample room for growth. Deeper penetration in Portugal markets and ability to capture untapped business opportunities in other EU markets will help the company improve its capacity utilization to ~80% by 2020.

At deal value of EUR135m, this transaction is valued at 10.5x and 8.5x CY16 and CY17 EV/ EBITDA, respectively. Despite the acquisition of businesses in Portugal and France, ARBP should end FY17 with net debt of <USD600m (with net debt/equity of ~0.55- 0.6x), at par with FY16.

Dolutegravir (DTG) – the next growth driver

- ARBP is the first generic company to sign license with ViiV Healthcare for the next generation Integrase Inhibitor – DTG.
 - Filed an ANDA application for DTG 50mg with USFDA under the PEPFAR program.
 - WHO announced this drug as a first line reserve drug in its 2015 HIV treatment guidelines.
 - Play a collaborative role in upgrading millions of patients to the latest best in-class ARV drug.
- Developing a triple drug combination containing DTG.
- Market size is expected to be USD2b in 2017; Triple combination drug containing DTG expected to garner major share.

Valuation and view

ARBP has outperformed most pharma peers over past 12 months, driven by a significant improvement in its operating performance post clearance of USFDA import alert and ramp-up in US launches, including high-margin gCymbalta. With the recent acquisition in EU (Actavis assets) and US (Natrol), the share of high-margin formulations in total revenues has increased to ~80% (v/s 54% in FY10), positioning it among large-cap formulation players. Our target price of INR900 discounts ARBP's 1HFY19E EPS at 18x P/E multiple, which is:

- At par with its 3-year average P/E multiple, which is justified given its stronger business profile and earnings outlook.
- At >20% discount to sector average target P/E multiple, factoring in higher leverage and potential execution related risks.
- Implies a PEG of 1.0x (FY17-19E EPS CAGR of 17%).

We believe that the re-rating of the stock from single-digit P/E multiple to current levels partly factors in transition to formulations player, improved execution in the US and moderation in leverage (from 1.2x D/E in FY10 to 0.4x in FY17E). However, current valuations at 13x FY18E are still at ~30-35% discount to the sector average, which is unjustified, in our view. We argue for P/E re-rating for ARBP due to:

- Strong EPS outlook of % CAGR backed
- Strong free cash flow generation.
- Deleveraging of balance sheet, as we expect D/E to improve to 0.2x by FY19E.

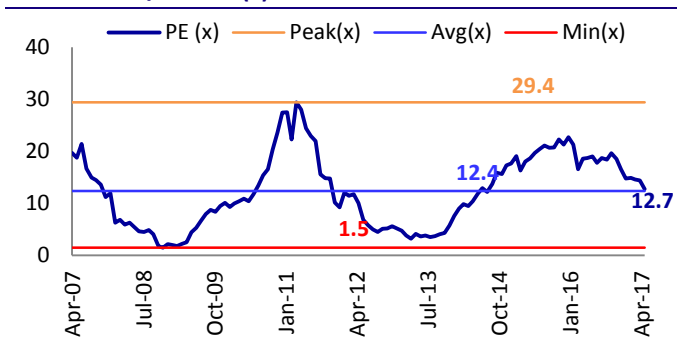
Key catalysts to drive the stock's performance over medium term:

- Improvement in EU profitability (30% of business), led by deeper penetration in existing markets and site transfer to India.
- Launch of high-margin products in the US, including injectables (25+ launches over next 18 months) and controlled substance.
- Focus on high-margin triple combination ARV products in Africa (from FY16E).

Risks to our investment assumptions:

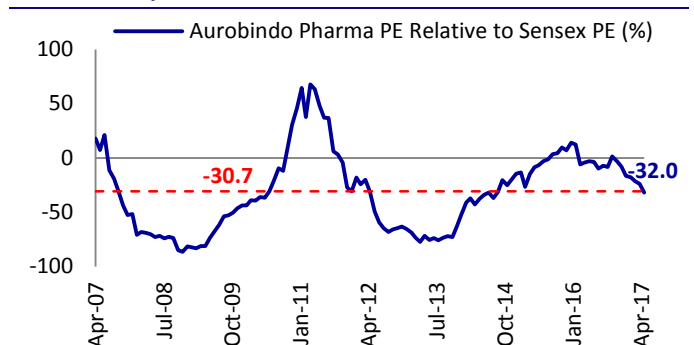
- Delay in ANDA approvals.
- Worsening of pricing environment in EU.
- Currency fluctuations both in USD and EUR terms.

Exhibit 12: P/E Band (x)



Source: Company, MOSL

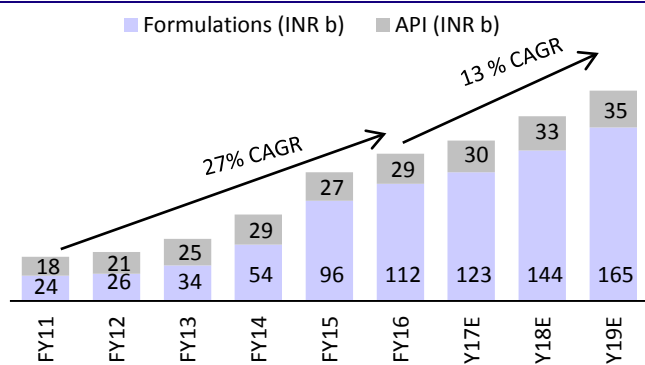
Exhibit 13: P/E relative to Sensex



Source: Company, MOSL

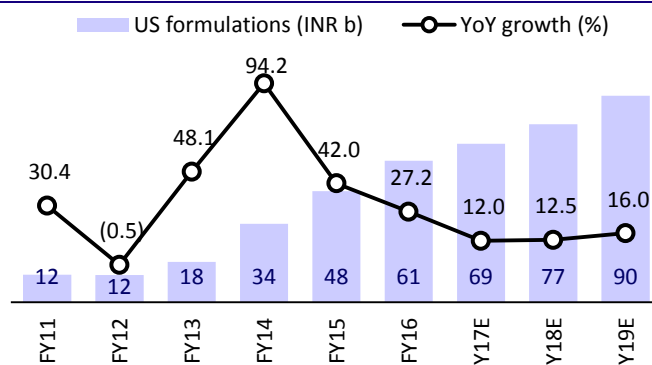
Story in charts

Exhibit 14: Formulation led sales growth (INR b)



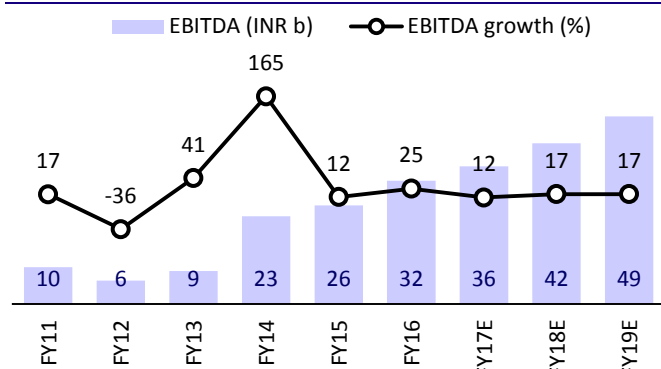
Source: Company, MOSL

Exhibit 15: US sales to grow at 14% CAGR over FY17-19E



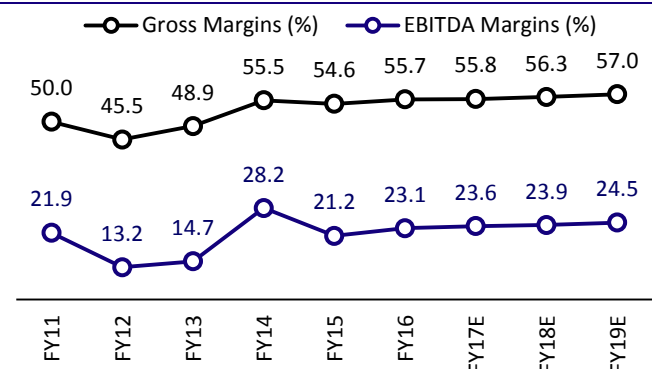
Source: Company, MOSL

Exhibit 16: EBITDA growth to improve in FY17-19E



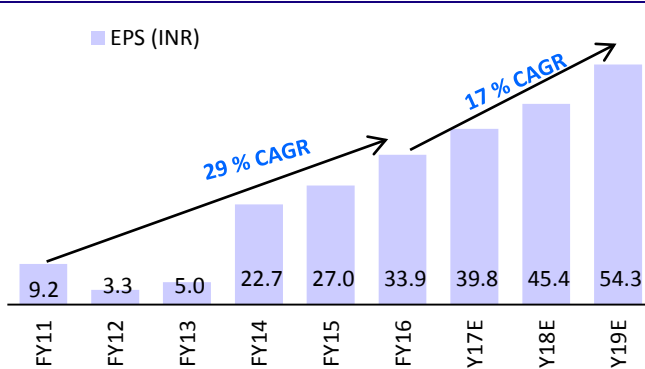
Source: Company, MOSL

Exhibit 17: EBITDA margins improving with product mix



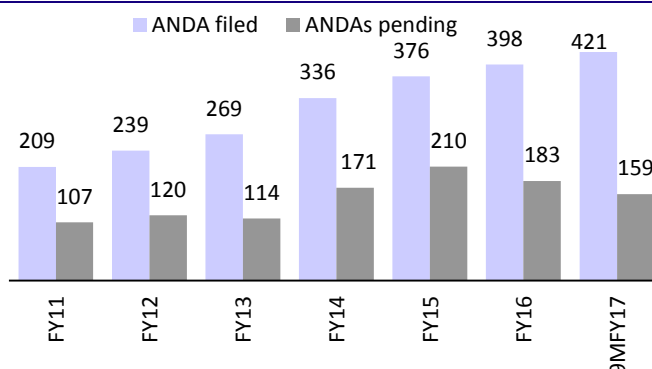
Source: Company, MOSL

Exhibit 18: EPS growth to sustain at 17%

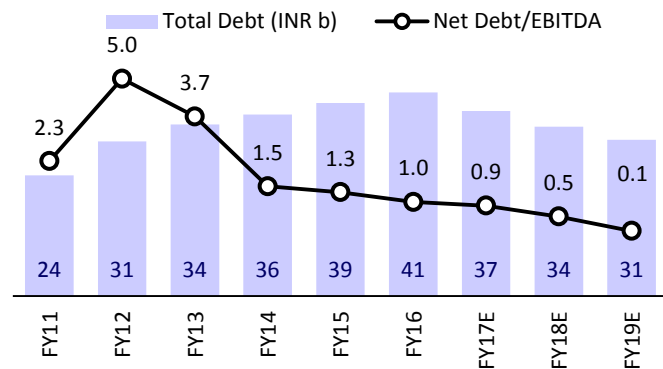


Source: Company, MOSL

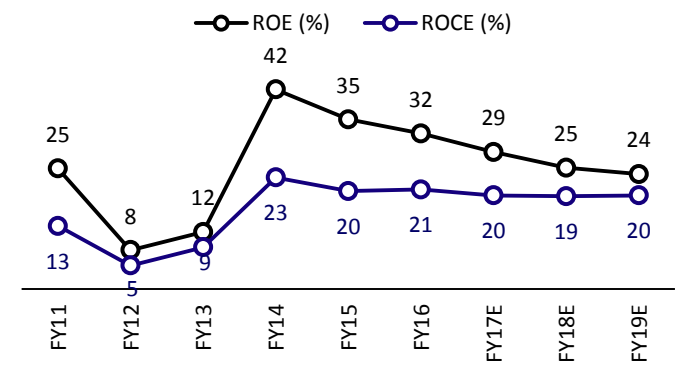
Exhibit 19: Rich ANDA pipeline



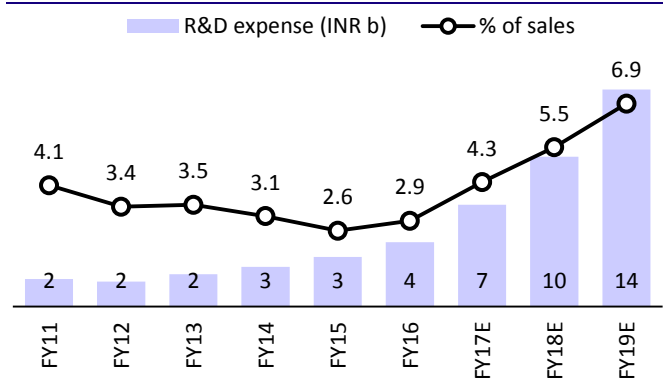
Source: Company, MOSL

Exhibit 20: Improving cash flows to reduce debt

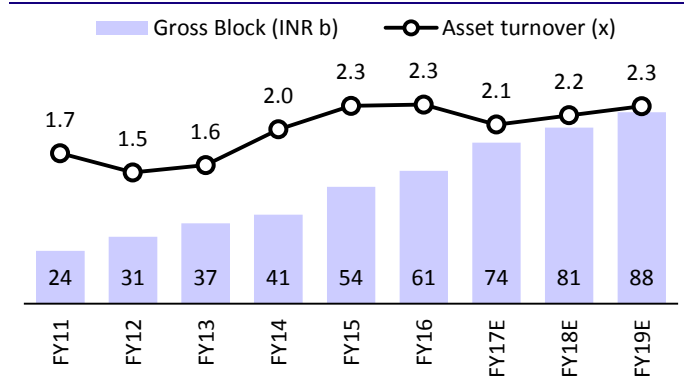
Source: Company, MOSL

Exhibit 21: Return ratios (%)

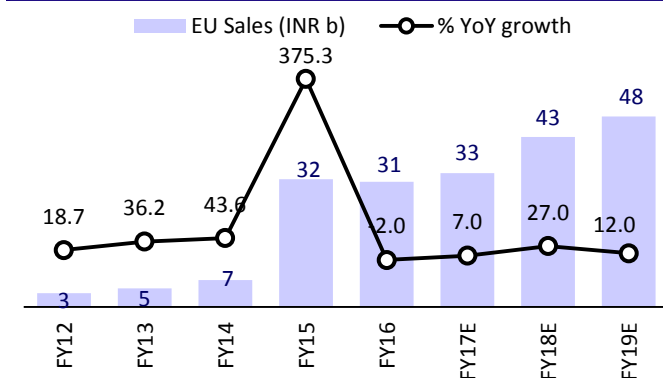
Source: Company, MOSL

Exhibit 22: R&D expense to increase going ahead

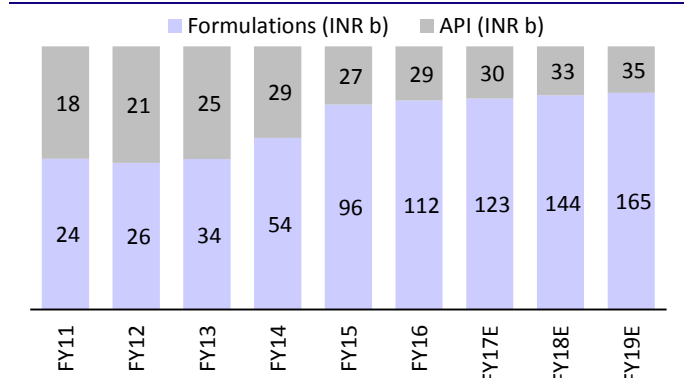
Source: Company, MOSL

Exhibit 23: Asset turnover improving

Source: Company, MOSL

Exhibit 24: EU business to grow at ~7%

Source: Company, MOSL

Exhibit 25: Formulation share getting bigger

Source: Company, MOSL

Financials and Valuations

Income Statement						(INR Million)		
Y/E Mar	2012	2013	2014	2015	2016	2017E	2018E	2019E
Net Sales	46,274	58,553	80,998	121,205	138,961	151,750	174,860	199,258
Change (%)	5.6	26.5	38.3	49.6	14.6	9.2	15.2	14.0
EBITDA	6,101	8,610	22,828	25,636	32,056	35,813	41,792	48,818
EBITDA Margin (%)	13.2	14.7	28.2	21.2	23.1	23.6	23.9	24.5
Depreciation	2,005	2,487	3,125	3,326	3,926	4,368	4,897	5,338
EBIT	4,096	6,122	19,703	22,310	28,130	31,445	36,895	43,481
Interest	1,028	1,313	1,079	843	927	815	926	747
Other Income	247	285	232	808	682	550	600	750
Extraordinary items	-5,445	-1,353	-2,031	-596	-660	430	0	0
PBT	-2,129	3,741	16,825	21,679	27,225	31,610	36,569	43,484
Tax	-888	827	3,635	5,966	7,444	8,377	10,057	11,741
Tax Rate (%)	41.7	22.1	21.6	27.5	27.3	26.5	27.5	27.0
Min. Int. & Assoc. Share	-6	-25	-38	-45	-39	-50	-55	-55
Reported PAT	-1,235	2,939	13,228	15,758	19,820	23,283	26,568	31,798
Adjusted PAT	1,939	2,939	13,228	15,758	19,820	23,283	26,568	31,798
Change (%)	-63.9	51.6	350.1	19.1	25.8	17.5	14.1	19.7

Balance Sheet						(INR Million)		
Y/E Mar	2012	2013	2014	2015	2016	2017E	2018E	2019E
Share Capital	582	582	583	584	585	585	585	585
Reserves	22,814	25,475	36,919	50,975	69,982	91,802	116,907	147,242
Net Worth	23,397	26,058	37,502	51,559	70,567	92,387	117,492	147,827
Debt	30,959	34,355	36,339	38,636	40,762	37,030	33,907	31,259
Deferred Tax	-16	680	2,054	2,058	2,364	2,411	2,459	2,508
Total Capital Employed	54,442	61,202	76,151	92,511	114,289	132,435	154,478	182,226
Gross Fixed Assets	30,863	37,080	41,066	53,821	61,224	74,224	81,224	88,224
Less: Acc Depreciation	8,916	11,246	14,613	17,405	19,713	24,081	28,977	34,315
Net Fixed Assets	21,947	25,834	26,453	36,416	41,511	50,143	52,246	53,909
Capital WIP	6,454	2,185	3,097	4,196	10,238	15,000	15,000	15,000
Investments	385	223	198	198	2	200	200	200
Current Assets	33,536	43,982	64,386	87,647	104,356	106,618	127,896	157,283
Inventory	15,456	19,236	23,675	36,113	40,881	44,103	50,245	56,338
Debtors	12,400	15,970	26,366	35,392	41,719	45,733	52,698	60,050
Cash & Bank	709	2,085	1,786	4,691	8,344	4,882	11,053	26,994
Loans & Adv, Others	4,972	6,692	12,559	11,451	13,412	11,900	13,900	13,900
Curr Liabs & Provns	7,880	11,576	18,747	36,587	42,704	40,413	41,751	45,052
Curr. Liabilities	7,174	10,685	17,389	34,161	40,641	39,488	40,826	44,127
Provisions	706	891	1,358	2,426	2,063	925	925	925
Net Current Assets	25,656	32,406	45,640	51,060	61,652	66,206	86,145	112,231
Total Assets	54,442	61,202	76,151	92,511	114,289	132,435	154,478	182,226

Financials and Valuations

Ratios

Y/E Mar	2012	2013	2014	2015	2016	2017E	2018E	2019E
Basic (INR)								
EPS	3.3	5.0	22.7	27.0	33.9	39.8	45.4	54.3
Cash EPS	6.8	9.3	28.1	32.7	40.6	47.3	53.8	63.5
Book Value	40.2	44.7	64.3	88.3	120.6	157.9	200.8	252.6
DPS	0.5	0.8	1.5	2.3	2.0	2.5	2.5	2.5
Payout (incl. Div. Tax.)	-23.6	14.9	6.6	8.3	5.9	6.3	5.5	4.6
Valuation(x)								
P/E			26.3	22.1	17.6	15.0	13.1	11.0
Cash P/E			21.2	18.2	14.7	12.6	11.1	9.4
P/BV			9.3	6.7	4.9	3.8	3.0	2.4
EV/Sales			4.7	3.2	2.7	2.5	2.1	1.8
EV/EBITDA			16.8	14.9	11.9	10.6	8.9	7.2
Dividend Yield (%)	0.1	0.1	0.3	0.4	0.3	0.4	0.4	0.4
FCF per share	-12.3	-0.1	-1.4	5.1	4.5	4.5	19.8	35.3
Profitability Ratios (%)								
RoE	8.1	11.9	41.6	35.4	32.5	28.6	25.3	24.0
RoCE	4.9	8.7	23.3	20.4	20.8	19.5	19.4	19.5
RoIC	5.4	9.2	24.2	20.9	22.8	22.2	22.2	23.7
Turnover Ratios (%)								
Asset Turnover (x)	0.8	1.0	1.1	1.3	1.2	1.1	1.1	1.1
Debtors (No. of Days)	96	97	116	105	107	107	107	107
Inventory (No. of Days)	122	120	107	109	107	106	105	103
Creditors (No. of Days)	96	118	137	136	150	144	138	137
Leverage Ratios (%)								
Net Debt/Equity (x)	1.3	1.3	1.0	0.7	0.6	0.4	0.3	0.2

Cash Flow Statement

(INR Million)

Y/E Mar	2012	2013	2014	2015	2016	2017E	2018E	2019E
Adjusted EBITDA	6,101	8,610	22,828	25,636	32,056	35,813	41,792	48,818
Non cash opr. exp (inc)	247	285	232	808	682	550	600	750
(Inc)/Dec in Wkg. Cap.	-1,288	-5,374	-13,533	-2,515	-6,939	-8,016	-13,768	-10,145
Tax Paid	-327	-132	-3,635	-5,966	-7,444	-8,377	-10,057	-11,741
Other operating activities	-5,445	-1,353	-2,031	-596	-660	430	0	0
CF from Op. Activity	-712	2,036	3,863	17,367	17,696	20,401	18,567	27,683
(Inc)/Dec in FA & CWIP	-6,446	-2,106	-4,656	-14,389	-15,062	-17,762	-7,000	-7,000
Free cash flows	-7,157	-70	-793	2,978	2,633	2,638	11,567	20,683
(Pur)/Sale of Invt	0	-163	-25	0	-196	198	0	0
Others	0	0	0	0	0	0	0	0
CF from Inv. Activity	-6,446	-2,269	-4,681	-14,388	-15,259	-17,564	-7,000	-7,000
Inc/(Dec) in Net Worth	474	159	-910	-386	359	0	0	0
Inc / (Dec) in Debt	6,828	3,403	2,131	2,298	2,464	-3,721	-3,110	-2,636
Interest Paid	-1,028	-1,313	-1,079	-843	-927	-815	-926	-747
Divd Paid (incl Tax) & Others	-276	-641	379	-1,142	-681	-1,762	-1,360	-1,359
CF from Fin. Activity	5,998	1,608	520	-73	1,215	-6,298	-5,396	-4,742
Inc/(Dec) in Cash	-1,159	1,376	-298	2,905	3,652	-3,461	6,171	15,941
Add: Opening Balance	1,867	709	2,085	1,786	4,691	8,344	4,882	11,053
Closing Balance	708	2,084	1,786	4,691	8,343	4,883	11,053	26,994

NOTES

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