

INDUSTRY PHARMA

CMP (as on 30 May 17) Rs 580

Target Price Rs 740

Nifty 9,625

Sensex 31,159

KEY STOCK DATA

Bloomberg ARBP IN

No. of Shares (mn) 586

MCap (Rs bn) / (\$ mn) 340/5,261

6m avg traded value (Rs mn) 1,552

STOCK PERFORMANCE (%)

52 Week high / low Rs 895/503

3M 6M 12M

Absolute (%) (14.3) (21.7) (23.1)

Relative (%) (22.7) (38.6) (39.7)

SHAREHOLDING PATTERN (%)

Promoters 51.9

FIs & Local MFs 12.7

FPIs 21

Public & Others 14.4

Source : BSE

Amey Chalke

amey.chalke@hdfcsec.com

+91-22-6171-7321

Siddhant Mansukhani

siddhant.mansukhani@hdfcsec.com

+91-22-6639-2476

Muted performance

Aurobindo's (ARBP) revenue declined ~3% YoY to Rs 36bn in 4QFY17, EBITDA was down 17% Rs 7.2bn (margin at ~20%), and PAT was down ~5% YoY at Rs 5.3bn. The sub-par top-line result was owing to lower sales in the US market (flat YoY). The EBITDA margin decline was due to higher other expenses, which had a one-time inventory write off of Rs 500-550mn. However, even adjusted for the same, the EBITDA margin would have been ~21.5%, well below expectations. Lower tax expenses during the quarter provided some relief to the bottom line.

While ARBP is now evolving into a complex generics player, this transformation still has some way to go. Also, being a pure generics player, ARBP's business model remains very susceptible to the buyer consolidation and competitive pressures in the US market. As a result, we cut our earnings multiple from 18x to 16x.

We have also cut our earnings estimates by 7% /11% for FY18E/FY19E resp, considering the rupee appreciation, rising R&D costs and higher than expected base business erosion in the US, which will partially offset the benefits of the complex generics

Financial Summary

(Rs mn)	4QFY17	4QFY16	YoY (%)	3QFY17	QoQ (%)	FY16	FY17E	FY18E	FY19E
Net Sales	36,023	37,010	(2.7)	38,640	(6.8)	135,617	146,844	161,907	177,355
EBIDTA	7,212	8,663	(16.7)	8,948	(19.4)	31,881	34,342	37,995	42,344
APAT	5,286	5,545	(4.7)	5,724	(7.6)	20,250	23,016	24,422	27,177
Diluted adj. EPS (Rs)	9.0	9.5	(4.7)	9.8	(7.6)	34.6	39.3	41.7	46.4
P/E (x)						16.8	14.8	13.9	12.5
RoE (%)						32.5	27.6	23.2	21.0

Source: Company, HDFC sec Inst Research # Consolidated

HDFC securities Institutional Research is also available on Bloomberg HSLB <GO> & Thomson Reuters

transition. Expect ~9% earnings CAGR over FY17-19E. Maintain a BUY rating with a revised TP of Rs 740 (16x FY19E)

- At present, ~45% of ARBP's revenues come from the US-generics business. While the base is high at ~US\$ 1bn, ARBP has ~115 ANDAs pending with the US FDA, of which ~40 are injectables. Progress in injectables, oncology and other niche categories will be crucial in order to maintain growth. We forecast ~10% US rev. CAGR over FY17-19E.

Highlights of the quarter

- Concall takeaways:** (1) Base business price erosion was 7 to 8% YoY in 4QFY17, (2) Launched six new products in the US in 4Q, recd. 14 approvals and filed eight ANDAs, (3) Injectables' growth momentum is likely to sustain, (4) In-licensed a fifth biosimilar, clinical trials to begin in FY19, (5) Net debt stands at US\$ 439mn vs US\$ 640mn at the end of FY16, (6) FY18 capex guidance of US\$ 120mn (ex-biosims and vaccines) and (7) Status quo in the DoJ case.
- Near-term outlook:** Important product approvals remain the key near-term triggers.

Revenues declined ~3% YoY, ~10% below estimates

EBITDA declined by ~17%. Contributing to this was a one-time inventory write off of Rs 500-550mn. However, even adjusted for this, the margin was ~21.5%, ~200 bps below estimates

The gross margin improved by ~200bps owing to a favourable geographic mix and lower contribution from the ARV business

However, this was offset by an increase in employee costs

Quarterly Financials Snapshot (Consolidated)

Particulars	4QFY17	4QFY16	YoY (%)	3QFY17	QoQ (%)
Net Sales	36,023	37,010	(2.7)	38,640	(6.8)
Material Expenses	14,635	15,809	(7.4)	16,675	(12.2)
Employee Expenses	4,635	4,068	13.9	4,456	4.0
Other Expenses	9,541	8,469	12.7	8,560	11.5
EBITDA	7,212	8,663	(16.7)	8,948	(19.4)
Depreciation	1,001	1,114		1,111	
EBIT	6,212	7,549	(17.7)	7,837	(20.7)
Other Income	218	210		79	
Interest Cost	143	251		143	
FX Gains / (Loss)	190	101		158	
PBT	6,477	7,610	(14.9)	7,932	(18.3)
Tax	1,172	2,064		2,177	
Minority Interest	(19)	(1)		(31)	
RPAT	5,286	5,545	(4.7)	5,724	(7.6)
EO Items (Adj For Tax)	-	-		-	
APAT	5,286	5,545	(4.7)	5,724	(7.6)

Source: Company, HDFC sec Inst Research

Margin Analysis

	4QFY17	4QFY16	YoY (bps)	3QFY17	QoQ (bps)
Material Expenses % Net Sales	40.6	42.7	(209)	43.2	(253)
Employee Expenses % Net Sales	12.9	11.0	187	11.5	133
Other Expenses % Net Sales	26.5	22.9	360	22.2	433
EBITDA Margin (%)	20.0	23.4	(339)	23.2	(314)
Tax Rate (%)	18.1	27.1	(903)	27.4	(936)
APAT Margin (%)	14.7	15.0	(31)	14.8	(14)

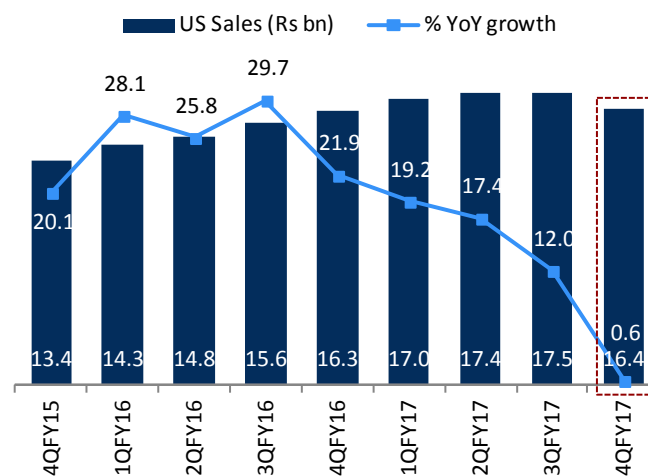
Source: Company, HDFC sec Inst Research

The US business remained flat YoY, as growth was offset by the 7-8% price erosion in the base business

EU segment declined 8% YoY, while the EM segment recorded strong growth of 21%. The Generis acquisition will be consolidated from 1QFY18

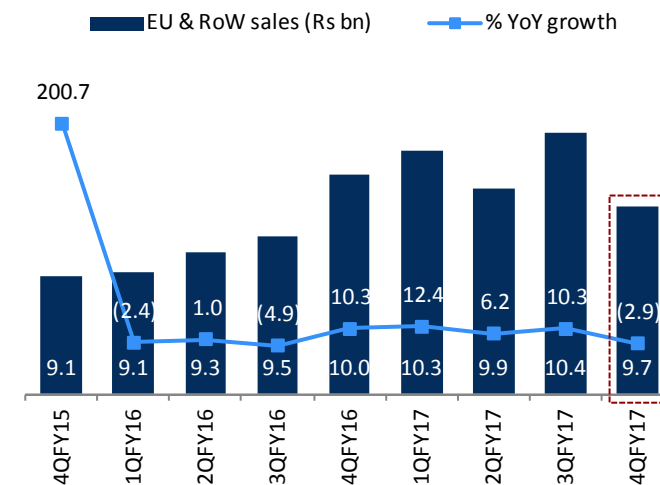
The gross margin improved by ~200bps YoY, while the EBITDA margin declined by ~340bps YoY

US Formulations Growth: Subdued



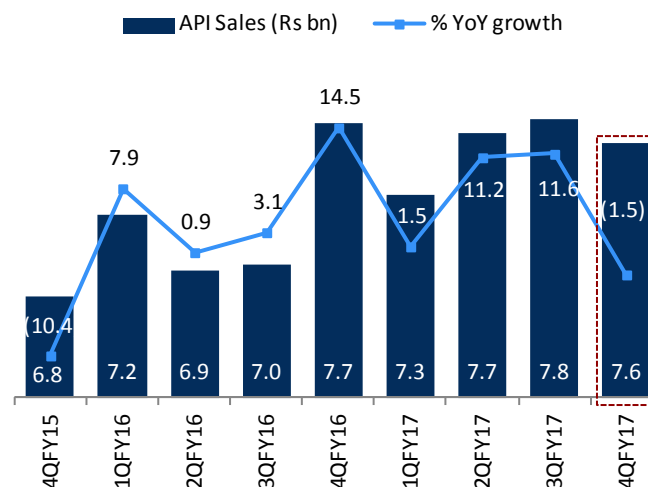
Source: Company, HDFC sec Inst Research

EU Declines (-8%), Strong EM Growth (21%)



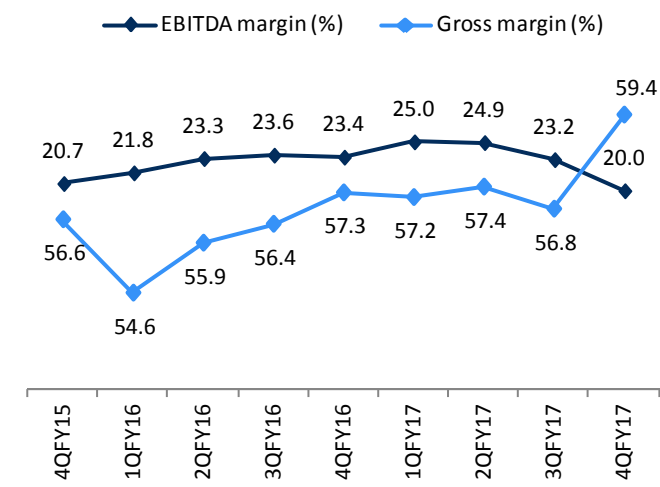
Source: Company, HDFC sec Inst Research

API Revenues: Flat YoY



Source: Company, HDFC sec Inst Research

EBITDA & Gross Margin Trajectories



Source: Company, HDFC sec Inst Research

US business under-performed during the quarter, partly on account of new launches only towards the end of the quarter

Due to the tender-driven nature of the ARV business, ARBP is focusing more on the bottom-line in this segment, which may affect top-line growth, depending on tender prices

Overall top line is expected to grow at ~10% CAGR over FY17-19E

Segmental Quarterly Performance

(Rs mn)	4QFY17	4QFY16	YoY (%)	3QFY17	QoQ (%)
US	16,432	16,341	0.6	17,451	(5.8)
Europe & RoW	9,743	10,037	(2.9)	10,432	(6.6)
ARVs	2,619	3,284	(20.2)	3,419	(23.4)
Formulation (sub-total)	28,794	29,662	(2.9)	31,302	(8.0)
Betalactum	5,121	5,020	2.0	5,250	(2.5)
Non Betalactum	2,506	2,726	(8.1)	2,509	(0.1)
APIs (sub-total)	7,627	7,746	(1.5)	7,759	(1.7)
Total	36,421	37,408	(2.6)	39,061	(6.8)

Source: Company, HDFC sec Inst Research

Assumptions

	FY16	FY17	FY18E	FY19E
US	60,786	68,272	73,893	82,427
Growth (%)	30.1	12.3	8.2	11.5
Europe	31,304	32,771	38,014	40,295
Growth (%)	(2.0)	4.7	16.0	6.0
ARV	12,093	11,854	13,632	15,677
Growth (%)	25.5	(2.0)	15.0	15.0
RoW	6,461	7,556	8,689	9,993
Growth (%)	13.7	16.9	15.0	15.0
SSPs - API	8,708	9,886	10,380	10,899
Growth (%)	0.8	13.5	5.0	5.0
Ceph - API	9,858	10,548	11,181	11,852
Growth (%)	6.0	7.0	6.0	6.0
ARVs - API	10,270	9,986	10,485	11,010
Growth (%)	12.6	(2.8)	5.0	5.0
Total	139,480	150,873	166,276	182,153
Growth (%)	13.7	8.2	10.2	9.5

Source: HDFC sec Inst Research

ARBP trades at a significant discount to peers

Peer Valuations

	Mcap (Rs bn)	CMP (Rs/sh)	Reco	TP	Adj EPS (Rs/sh)			P/E (x)			RoE (%)		
					FY17P	FY18E	FY19E	FY17P	FY18E	FY19E	FY17P	FY18E	FY19E
Sun Pharma	1,222	508	NEU	650	26.9	32.8	37.6	18.9	15.5	13.5	17.9	13.9	16.4
Lupin	508	1,130	BUY	1,800	59.4	62.6	81.9	19.0	18.1	13.8	21.8	19.3	21.3
Cadila	483	472	BUY	500	12.2	16.9	21.7	38.7	27.9	21.7	23.5	23.4	25.3
Dr Reddy's	421	2481	NEU	2,685	72.7	115.2	147.3	34.2	21.5	16.8	9.5	14.5	16.3
Cipla	410	511	NEU	495	15.7	19.4	24.7	32.6	26.3	20.7	10.5	11.8	13.5
Aurobindo	340	580	BUY	740	39.3	41.7	46.4	14.8	13.9	12.5	27.6	23.2	21.0
Alkem Labs	224	1,874	NEU	2050	76.4	80.4	106.4	24.5	23.3	17.6	21.9	18.6	20.7
Torrent Pharma	209	1,235	BUY	1,525	49.5	68.9	90.2	25.0	17.9	13.7	22.1	20.3	23.1
Glenmark	176	624	BUY	1,100	29.6	39.4	53.6	21.1	15.8	11.6	18.1	19.9	21.7
Divis Labs	156	588	BUY	705	42.4	38.5	45.4	13.9	15.3	13.0	22.0	17.5	18.4
Alembic Pharma	102	539	BUY	675	28.6	25.7	33.8	18.8	21.0	15.9	23.0	23.2	25.1
Granules India	31	136	BUY	190	7.2	8.3	11.7	19.0	16.4	11.6	21.0	19.3	22.8

Source: HDFC sec Inst Research

Change In Estimates (Consolidated)

Rs mn	Previous		New		% Chg	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Net Sales	172,741	195,005	164,480	180,186	(4.8)	(7.6)
EBITDA	40,662	47,073	37,995	42,344	(6.6)	(10.0)
APAT	26,161	30,362	24,422	27,177	(6.6)	(10.5)

Source: HDFC sec Inst Research

Income Statement (Consolidated)

Year ending March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Net Revenues	121,205	138,072	149,294	164,480	180,186
Growth (%)	50.8	13.9	8.1	10.2	9.5
Material Expenses	55,056	61,621	64,343	70,726	76,579
Employee Expenses	13,023	15,426	17,678	18,751	20,361
SG&A Expenses	10,975	9,838	11,190	9,540	9,730
Other Operating Expenses	16,515	19,306	21,742	27,468	31,172
EBITDA	25,636	31,881	34,342	37,995	42,344
EBITDA Margin (%)	21.2	23.1	23.0	23.1	23.5
EBITDA Growth (%)	12.3	24.4	7.7	10.6	11.4
Depreciation	3,326	3,924	4,276	4,668	5,448
EBIT	22,310	27,957	30,066	33,327	36,895
Other Income (Including EO Items)	808	701	538	650	750
Interest	843	927	667	598	491
PBT	22,275	27,732	29,937	33,379	37,154
Tax (Incl Deferred)	5,966	7,207	7,596	9,012	10,032
RPAT	16,309	20,524	22,340	24,367	27,122
Minority Interest	(45)	(30)	(55)	(55)	(55)
EO (Loss) / Profit (Net Of Tax)	596	304	(621)	-	-
APAT	15,758	20,250	23,016	24,422	27,177
APAT Growth (%)	19.1	28.5	13.7	6.1	11.3
Adjusted EPS (Rs)	27.0	34.6	39.3	41.7	46.4

Source: Company, HDFC sec Inst Research

*FY15 numbers are as per the old reporting standards. FY16 and FY17 are as per IND-AS.

Balance Sheet (Consolidated)

Year ending March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
SOURCES OF FUNDS					
Share Capital - Equity	584	585	586	586	586
Reserves	50,975	72,288	93,133	116,090	141,803
Total Shareholders Funds	51,559	72,873	93,719	116,676	142,389
Minority Interest	258	26	21	21	22
Long Term Debt	13,615	7,428	1,814	1,361	1,020
Short Term Debt	25,021	36,727	29,027	27,576	26,197
Total Debt	38,636	44,155	30,841	28,936	27,217
Net Deferred Taxes	2,058	(1,823)	(1,185)	(1,208)	(1,232)
Long Term Provisions & Others	629	234	224	450	550
TOTAL SOURCES OF FUNDS	93,139	115,464	123,621	144,875	168,945
APPLICATION OF FUNDS					
Net Block	38,112	33,804	40,831	50,162	54,714
CWIP	3,352	8,359	12,374	8,500	4,500
Goodwill	640	8,115	9,715	9,715	9,715
Investments	198	1,229	2,459	2,459	2,459
LT Loans & Advances	3,701	2,688	3,378	3,400	3,425
Total Non-current Assets	46,003	54,196	68,755	74,235	74,812
Inventories	36,113	40,561	43,305	44,567	48,255
Debtors	35,392	46,067	27,653	47,316	51,834
Other Current Assets	6,898	8,313	8,580	1,850	2,825
Cash & Equivalents	4,692	8,003	12,524	17,521	33,934
Total Current Assets	83,095	102,944	92,062	111,254	136,848
Creditors	20,511	24,570	24,883	27,114	29,215
Other Current Liabilities & Provns	15,447	17,105	12,313	13,500	13,500
Total Current Liabilities	35,958	41,675	37,196	40,614	42,715
Net Current Assets	47,136	61,268	54,866	70,640	94,133
TOTAL APPLICATION OF FUNDS	93,139	115,464	123,621	144,875	168,945

Source: Company, HDFC sec Inst Research

*FY15 numbers are as per the old reporting standards. FY16 and FY17 are as per IND-AS.

Cash Flow

Year ending March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Reported PBT	21,467	27,030	29,398	32,729	36,404
Non-operating & EO items	47	(5,819)	584	(79)	(79)
Interest expenses	843	927	667	598	491
Depreciation	3,326	3,924	4,276	4,668	5,448
Working Capital Change	(2,515)	(8,121)	10,224	(10,573)	(7,006)
Tax Paid	(5,966)	(11,088)	(6,958)	(9,036)	(10,056)
OPERATING CASH FLOW (a)	17,202	6,852	38,192	18,307	25,203
Capex	(14,388)	(11,041)	(16,917)	(10,126)	(6,000)
Free cash flow (FCF)	2,814	(4,189)	21,275	8,181	19,203
Investments	(1,065)	839	(521)	134	135
Non-operating Income	808	701	538	650	750
INVESTING CASH FLOW (b)	(14,646)	(9,501)	(16,899)	(9,342)	(5,115)
Debt Issuance/(Repaid)	2,296	5,519	(13,314)	(1,905)	(1,719)
Interest Expenses	(843)	(927)	(667)	(598)	(491)
FCFE	4,010	1,945	7,311	6,462	17,878
Share Capital Issuance	1	1	1	-	-
Dividend	(1,314)	(1,170)	(1,465)	(1,465)	(1,465)
Others	209	2,536	(1,326)	(0)	(0)
FINANCING CASH FLOW (c)	349	5,960	(16,771)	(3,967)	(3,675)
NET CASH FLOW (a+b+c)	2,905	3,311	4,521	4,997	16,413
EO Items, Others	-	-	-	-	-
Closing Cash & Equivalents	4,691	8,003	12,524	17,521	33,934

Source: Company, HDFC sec Inst Research

*FY15 numbers are as per the old reporting standards. FY16 and FY17 are as per IND-AS.

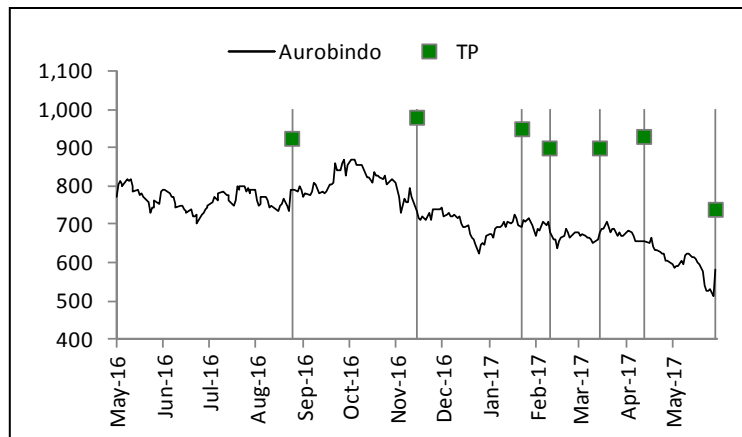
Key Ratios

	FY15	FY16	FY17E	FY18E	FY19E
PROFITABILITY (%)					
GPM	54.6	55.4	56.9	57.0	57.5
EBITDA Margin	21.2	23.1	23.0	23.1	23.5
APAT Margin	13.0	14.7	15.4	14.8	15.1
RoE	35.4	32.5	27.6	23.2	21.0
RoIC (or Core RoCE)	21.5	22.0	21.5	21.5	21.5
RoCE	20.1	21.4	21.5	20.8	21.0
EFFICIENCY					
Tax Rate (%)	26.8	26.0	25.4	27.0	27.0
Fixed Asset Turnover (x)	2.2	2.6	2.3	2.1	2.0
Inventory (days)	108.8	107.2	105.9	98.9	97.8
Debtors (days)	106.6	121.8	67.6	105.0	105.0
Other Current Assets (days)	20.8	22.0	21.0	4.1	5.7
Payables (days)	61.8	65.0	60.8	60.2	59.2
Other Current Liab & Provns (days)	46.5	45.2	30.1	30.0	27.3
Cash Conversion Cycle (days)	127.8	140.8	103.5	117.9	121.9
Debt/EBITDA (x)	1.5	1.4	0.9	0.8	0.6
Net D/E (x)	0.7	0.5	0.2	0.1	(0.0)
Interest Coverage (x)	26.5	30.1	45.1	55.8	75.1
PER SHARE DATA (Rs)					
EPS	27.0	34.6	39.3	41.7	46.4
Dividend	2.3	2.0	2.5	2.5	2.5
Book Value	88.3	124.5	160.0	199.1	243.0
VALUATION					
P/E (x)	21.5	16.8	14.8	13.9	12.5
P/BV (x)	6.6	4.7	3.6	2.9	2.4
EV/EBITDA (x)	14.5	11.8	10.4	9.2	7.9
EV/Revenues (x)	3.1	2.7	2.4	2.1	1.8
OCF/EV (%)	4.6	1.8	10.7	5.2	7.6
FCF/EV (%)	0.8	(1.1)	5.9	2.3	5.8
FCFE/Mkt Cap (%)	1.2	0.6	2.2	1.9	5.3
Dividend Yield (%)	0.4	0.3	0.4	0.4	0.4

Source: Company, HDFC sec Inst Research

*FY15 numbers are as per the old reporting standards. FY16 and FY17 are as per IND-AS.

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
25-Aug-16	790	BUY	925
16-Nov-16	734	BUY	980
23-Jan-17	715	BUY	950
10-Feb-17	679	BUY	900
15-Mar-17	653	BUY	900
13-Apr-17	657	BUY	930
30-May-17	580	BUY	740

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:

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HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

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