

Aurobindo Pharma

BSE SENSEX
38,645

S&P CNX
11,681

CMP: INR760 TP: INR910 (+20%)
Buy


Stock Info

Bloomberg	ARBPI
Equity Shares (m)	586
M.Cap.(INRb)/(USD\$)	445 / 6.2
52-Week Range (INR)	809 / 527
1, 6, 12 Rel. Per (%)	20/13/-19
12M Avg Val (INR M)	1657
Free float (%)	48.1

Financials Snapshot (INR b)

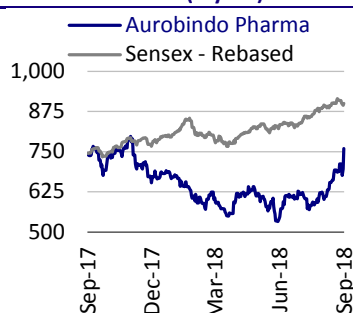
Y/E Mar	2018	2019E	2020E
Net Sales	165.0	183.3	251.9
EBITDA	37.9	40.3	56.2
PAT	25.0	25.9	34.6
EPS (INR)	42.7	44.2	59.1
Gr. (%)	8.7	3.5	33.8
BV/Sh (INR)	199.4	240.0	296.6
RoE (%)	23.8	20.1	22.0
RoCE (%)	17.4	15.3	15.9
P/E (x)	17.8	17.2	12.8
P/BV (x)	3.8	3.2	2.6

Shareholding pattern (%)

As On	Jun-18	Mar-18	Jun-17
Promoter	51.9	51.9	51.9
DII	15.8	15.6	14.2
FII	17.8	18.0	19.6
Others	14.5	14.5	14.3

FII Includes depository receipts

Stock Performance (1-year)



A Master Stroke

Sandoz deal at attractive valuation

- Aurobindo Pharma (ARBP) will acquire the dermatology and oral solids business (sales of USD0.6b in 1HCY18) from Sandoz for a cash consideration of USD900m (includes net working capital of ~USD220m).
- ARBP guided for sales of USD900m and a company-level EBITDA margin for the first 12 months post completion of the transaction (likely in 1QFY20). Accordingly, the deal turns out to be at an attractive valuation of ~1x EV/sales and ~4.3x EV/EBITDA.
- The acquisition would add ~300 products (commercialized ones as well as those in the pipeline) and enhance manufacturing capabilities in the US. This would complement the company's existing US business.
- We expect incremental PAT of ~USD92m on a 12-month basis from this deal. We raise our FY20 EPS estimate by 20% to INR59 to factor in this acquisition. We value ARBP at a 12-month forward P/E of 15x (unchanged) and revise our target price to INR910 (prior: INR750). Re-iterate Buy.

Deal to be EPS-accretive from first year of ownership: ARBP has entered into a definitive agreement with Sandoz, USA to acquire its dermatology and oral solids businesses. The upfront purchase price is USD900m in cash, which includes a potential upside in near-term earn-out and additional potential earn-out on pipeline products in outer years. The portfolio to be acquired has a revenue contribution of 70% from oral solids and 30% from dermatology. It had sales of USD1.2b in CY17 and USD600m in 1HCY18. ARBP guided for sales of USD900m in the first 12 months after the closure of transaction, adjusting for the expiration of certain in-licensed product contracts and the rationalization of the acquired products. The target businesses will be acquired on a 'debt free, cash free' basis and will be fully funded by debt. ARBP expects the transaction to be EPS-accretive to normalized EPS from the first full year of ownership.

Addition of products, manufacturing/commercial infra augurs well: The acquisition will add ~300 products, including those that are already commercialized and also the ones that are yet to be approved. The deal also adds two derma-dedicated manufacturing facilities (including dermatology dedicated R&D facility) in the US. In addition, ARBP will add a dedicated derma salesforce, which covers ~75% of total prescriptions. The commercial infrastructure provides a platform to build strong relationships with 'Big 3 Buyer' groups and expand presence among mid-tier buying groups. This would complement and expand ARBP's portfolio. The facilities had capacity utilization of 60-65% as of CY17.

Deal at attractive valuation: The sales guidance of USD900m on a 12-month basis post the closure of transaction and the EBITDA margin guidance of ~22-23% imply an EBITDA of ~USD198m. Given that ARBP would pay USD900m in total, it indicates attractive valuation of ~4.3x EV/EBITDA and ~1x EV/sales. Considering the interest cost, depreciation and tax outgo, we expect this deal to add ~USD92m in PAT on a 12-month basis.

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Valuation view: We raise our FY20 EPS estimate by 20% to INR59 to factor in incremental business in the portfolio acquired from Sandoz. We value ARBP at a 12-month forward P/E multiple of 15x (unchanged). Accordingly, we revise our TP to INR910 (prior: INR750). We remain positive on the stock on the back of its strong growth in the US, despite a high base. Robust pace of approvals (49 in FY18), a strong ANDA pipeline (112) pending for approval, consistency in regulatory compliance, and an improving EU business operating margin (on increased manufacturing from India facilities) are the key drivers for ARBP's growth in its focus markets. Re-iterate **Buy**.

Key concall takeaways

- ARBP believes that the EBITDA margin of the Sandoz portfolio (post acquisition) will be at a level similar to that of the consolidated-level EBITDA margin of ARBP.
- The net debt/equity ratio would increase from 0.3x to 0.6x due to addition of debt related to the acquisition.
- Cost of funds for acquisition is about 4%.
- The acquisition price includes working capital of USD220m.
- Acquired assets include ANDAs that are approved as well as pending for approval.
- Branded business in this acquisition is about USD50m.
- Tentative timeline for the completion of transaction would be 6-9 months.

We estimate addition of USD92m PAT from this deal on 12M basis

The sales guidance of USD900m on a 12-month basis post the closure of transaction and the EBITDA margin guidance of ~22-23% imply an EBITDA of ~USD198m. Given the interest cost, depreciation and tax outgo, we expect this deal to add ~USD90m in PAT on a 12-month basis.

Exhibit 1: Pro forma P&L indicates addition of USD92m in PAT from deal on a 12M basis

Particulars (USD m)	12M basis
Sales	900
EBITDA margin estimate (%)	22
EBITDA	198
Assuming 4% interest cost on debt	36
Assuming 10% as depreciation rate	40
PBT	122
Tax @ 25%	31
PAT	92

Source: MOSL

Deal enhances product portfolio, manufacturing capabilities

This acquisition will add ~300 products (including those under development) and enhance commercial/manufacturing capabilities in the US, thereby complementing and expanding the group's portfolio and pipeline.

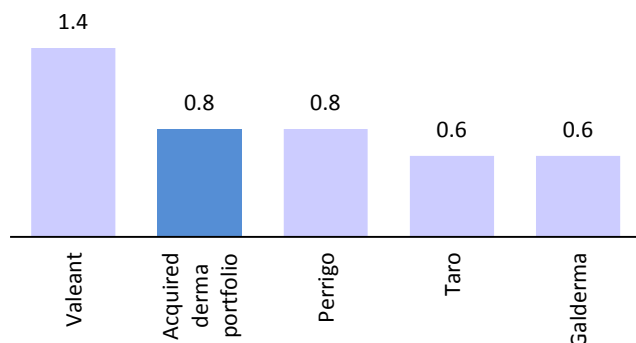
The company will become the second largest derma player in the US in both generic and branded products. The acquired generic dermatology portfolio includes various products in the derma segment therapeutic areas, such as topical antibiotics, gynecological and dermatological antifungal agents, anti-acne agents, local anesthetic, analgesics, anti-itch, and dermatological chemotherapeutic agents.

Products in the oral solids segment span across therapies such as auto-immune disease, anti-neoplastic agents, and a variety of hormonal agents.

The portfolio of 300 products also includes ANDAs that have already been filed, products under development and FTF opportunities (with potential of exclusivity).

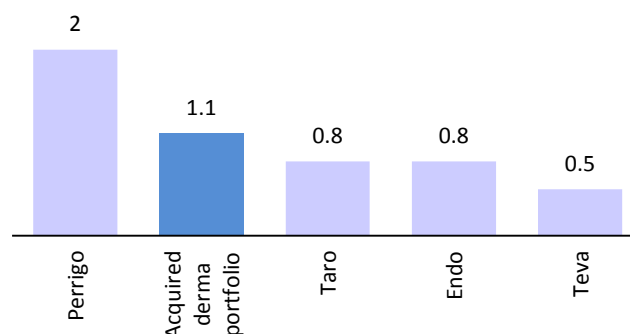
The commercial infrastructure provides a platform to build strong relationships with 'Big 3 Buyer' groups and an opportunity to expand presence among mid-tier buying groups.

Exhibit 2: Second largest derma portfolio in terms of value...



Note: Sales are at gross level as represented by IQVIA; Source: Company, MOSL

Exhibit 3: ...and volume



Note: Sales are at gross level as represented by IQVIA Source: Company, MOSL

Acquisition to provide strong presence in derma segment

Sandoz's derma portfolio is amongst the leaders in the generic business – second largest in terms of value and volume (as of 2017). It is also well recognized with patients, pharmacists and retail/wholesale customers. Sandoz's portfolio meets almost 80% of the dermatologists' prescribing needs. In addition, it gets dedicated derma salesforce, which covers ~75% of total prescriptions.

It is amongst the top five derma brands in US branded generics, with presence in diverse therapy areas like onychomycosis, external genital warts, fungal infections, steroid responsive dermatoses, and dry skin.

Synergy benefits to accrue with increased sourcing from ARBP's India facility

ARB P will be able to leverage its already vertically integrated and highly efficient manufacturing base to enhance its position of the acquired portfolio. It will also be able to take advantage of its existing operating infrastructure in the US.

The acquisition will also provide the company with an opportunity to partner with the leading global companies to market in-license and AG products. It will also help ARBP to strengthen its relationships with the 'Big 3 Buyer' groups.

Valuation and view

Long-term industry view

US to remain focus geography

- With increased competition in small molecules, faster pace of approvals from the USFDA and reasonable experience in US generics, pharma companies have moved up the value chain toward larger molecules, which are either difficult to develop and/or difficult to manufacture. This lowers competition, and thus, helps companies to better their sales and profitability. The phase of superior business from such molecules is subject to lead time for a company compared to peers.
- At the same time, companies with a reasonable base business are facing pricing pressure on account of increased competition. Thus, there is ongoing leakage in the base business. Pharma companies are strategizing to have a pipeline of complex generics in order to not only tackle price erosion in base business but also grow over the medium-to-long term.
- In FY18, intense pricing pressure and lower approvals adversely impacted growth of the US business. Regulatory headwinds further worsened the situation.
- We believe that given their strong R&D base, manufacturing capacity and considerable ongoing effort toward successful compliance, Indian pharma companies are poised for better growth, going forward.

ARBP in this backdrop

Unlike peers that reported a sharp decline in US sales, ARBP delivered 9% YoY growth in US sales in FY18 led by its strong launch momentum and diversified portfolio. US sales accounted for 45% of its overall sales in FY18.

Even on a high base of ~USD1.1b US sales, we expect ARBP to deliver 37% sales CAGR over FY18-20, driven by the addition of Sandoz portfolio and new launches.

We raise our FY20 EPS estimate by 20% to INR59 to factor in incremental business in the portfolio acquired from Sandoz. We value ARBP at a 12-month forward P/E multiple of 15x (unchanged). Accordingly, we revise our TP to INR910 (prior: INR750). Maintain Buy.

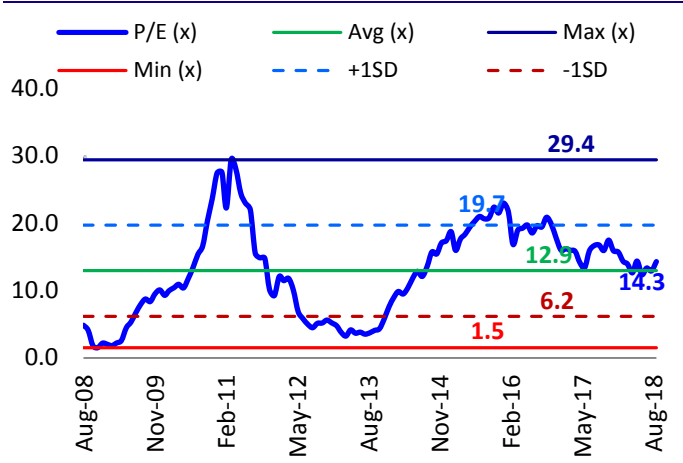
Key catalysts to drive stock's performance over medium term:

- Strong momentum in ANDA approvals and subsequent launches
- Increased outsourcing from India facility for Europe business
- Reduction in financial leverage

Key risks to our investment thesis

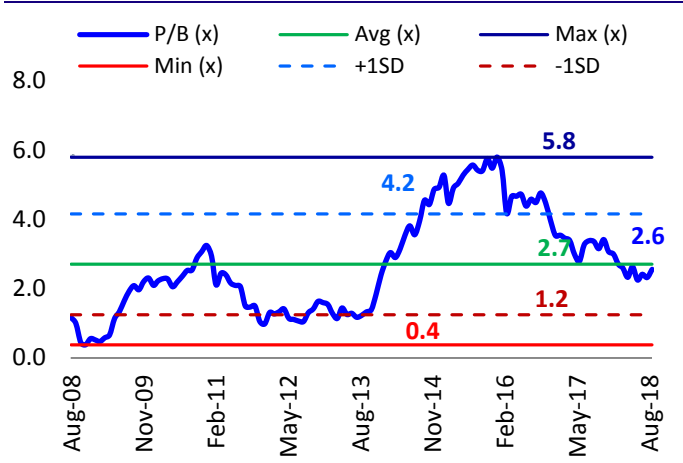
- Regulatory delays affecting key US launches
- Higher-than-expected price erosion in both its existing and Sandoz portfolios.
- Lower-than-expected operating leverage in Europe business.

Exhibit 1: P/E trend



Source: Company, MOSL

Exhibit 2: P/B trend



Source: Company, MOSL

Story in charts

Exhibit 3: Formulation led sales growth

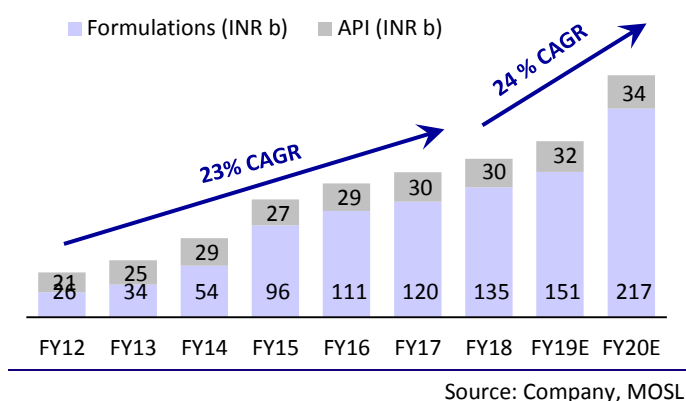


Exhibit 4: Sandoz portfolio to boost US business

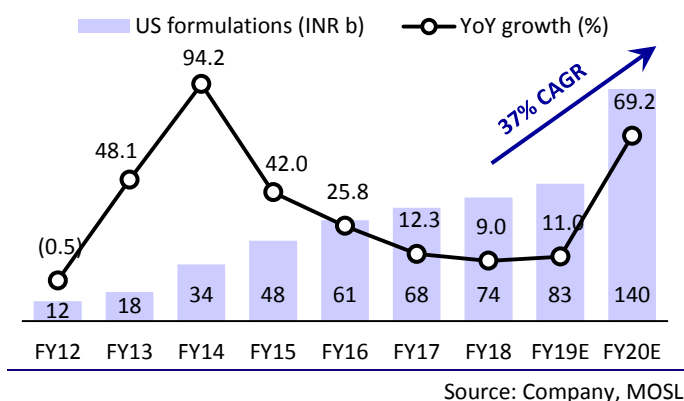


Exhibit 5: Margins to remain stable over FY18-20

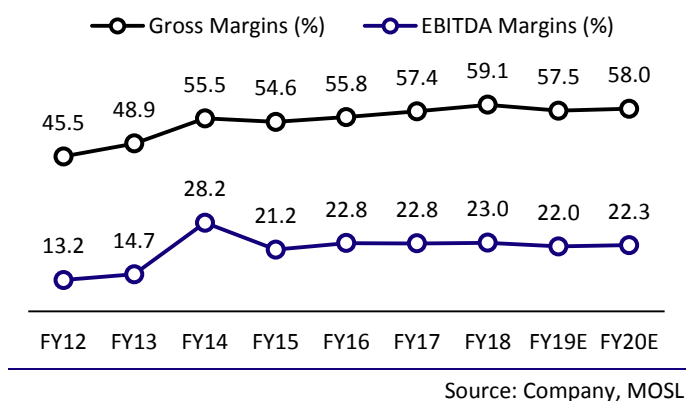


Exhibit 6: EBITDA to exhibit 22% CAGR over FY18-20

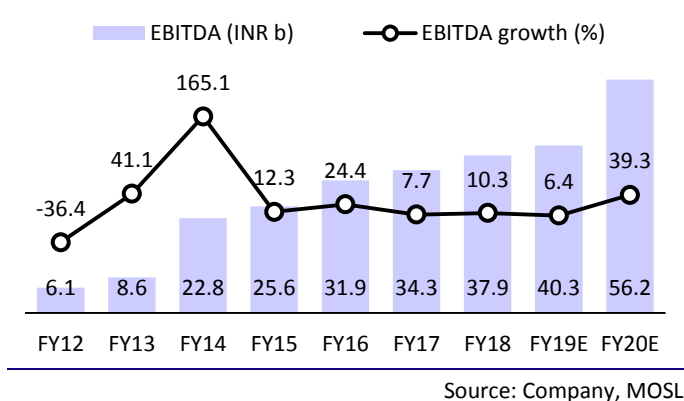


Exhibit 7: R&D expense to increase led by development of complex molecules

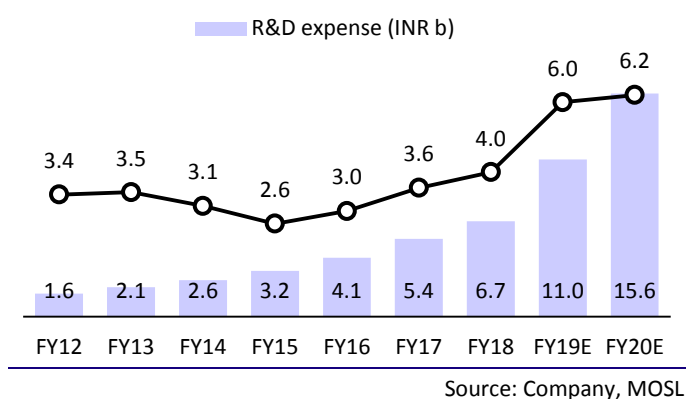
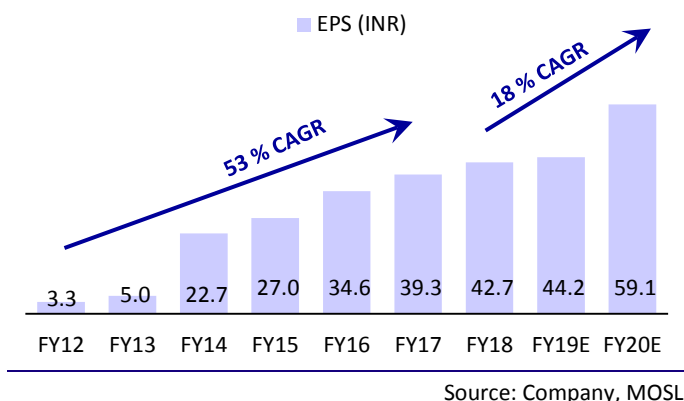


Exhibit 8: Expect EPS CAGR of ~18% over FY18-20



Financials and Valuations

Consolidated - Income Statement

(INR Million)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Total Income from Operations	80,998	121,205	139,553	150,897	164,998	183,259	251,861
Change (%)	38.3	49.6	15.1	8.1	9.3	11.1	37.4
Total Expenditure	58,170	95,569	107,671	116,556	127,113	142,942	195,696
% of Sales	71.8	78.8	77.2	77.2	77.0	78.0	77.7
EBITDA	22,828	25,636	31,882	34,341	37,885	40,317	56,165
Margin (%)	28.2	21.2	22.8	22.8	23.0	22.0	22.3
Depreciation	3,125	3,326	3,924	4,276	5,580	6,186	8,704
EBIT	19,703	22,310	27,958	30,065	32,305	34,131	47,461
Int. and Finance Charges	1,079	843	927	667	777	865	2,283
Other Income	232	808	701	538	1,020	800	500
PBT bef. EO Exp.	18,856	22,275	27,733	29,936	32,548	34,066	45,678
EO Items	-2,031	-596	-304	621	-168	-682	0
PBT after EO Exp.	16,825	21,679	27,429	30,557	32,380	33,384	45,678
Current Tax	3,635	5,966	7,207	7,596	8,183	8,176	11,100
Deferred Tax	0	0	0	0	0	0	0
Tax Rate (%)	21.6	27.5	26.3	24.9	25.3	24.5	24.3
Less: Mionrity Interest	-38	-45	-30	-55	-34	-55	-55
Reported PAT	13,228	15,758	20,252	23,015	24,231	25,263	34,633
Adjusted PAT	13,228	15,758	20,251	23,015	25,021	25,890	34,633
Change (%)	350.1	19.1	28.5	13.6	8.7	3.5	33.8
Margin (%)	16.3	13.0	14.5	15.3	15.2	14.1	13.8

Consolidated - Balance Sheet

(INR Million)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Equity Share Capital	583	584	585	586	586	586	586
Total Reserves	36,919	50,975	72,288	93,133	116,218	140,016	173,185
Net Worth	37,502	51,559	72,873	93,719	116,804	140,602	173,771
Minority Interest	257	258	26	21	18	19	19
Deferred Liabilities	2,054	2,058	-1,823	-1,185	765	780	796
Total Loans	36,339	38,636	44,155	30,841	44,825	41,682	101,021
Capital Employed	76,151	92,511	115,230	123,397	162,413	183,083	275,606
Gross Block	41,066	53,821	41,312	53,650	70,719	80,719	114,869
Less: Accum. Deprn.	14,613	17,405	3,455	7,168	11,843	18,029	26,733
Net Fixed Assets	26,453	36,416	37,856	46,482	58,876	62,690	88,136
Goodwill on Consolidation	764	640	4,063	4,063	8,165	8,165	8,165
Capital WIP	3,097	4,196	8,359	12,374	13,995	13,995	13,995
Total Investments	198	198	1,230	2,459	3,115	3,115	3,115
Curr. Assets, Loans&Adv.	64,386	87,647	105,631	95,439	125,312	135,908	213,530
Inventory	23,675	36,113	40,561	43,305	58,584	53,346	72,453
Account Receivables	26,366	35,392	46,067	35,042	30,844	55,229	75,903
Cash and Bank Balance	1,786	4,691	8,003	5,135	12,616	16,334	54,173
Loans and Advances	12,559	11,451	11,001	11,957	23,268	11,000	11,000
Curr. Liability & Prov.	18,747	36,587	41,909	37,420	47,051	40,792	51,336
Account Payables	13,512	20,511	24,570	24,883	26,274	28,167	38,711
Other Current Liabilities	3,877	13,650	15,776	11,415	18,209	12,000	12,000
Provisions	1,358	2,426	1,563	1,123	2,568	625	625
Net Current Assets	45,640	51,060	63,722	58,019	78,260	95,117	162,194
Appl. of Funds	76,151	92,511	115,230	123,397	162,413	183,083	275,606

Financials and Valuations

Ratios							
Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Basic (INR)							
EPS	22.7	27.0	34.6	39.3	42.7	44.2	59.1
Cash EPS	28.1	32.7	41.3	46.6	52.2	54.7	74.0
BV/Share	64.3	88.3	124.5	160.0	199.4	240.0	296.6
DPS	1.5	2.3	2.0	2.5	2.5	2.5	2.5
Payout (%)	6.6	8.3	5.8	6.4	6.0	5.8	4.2
Valuation (x)							
P/E				19.3	17.8	17.2	12.8
Cash P/E				16.3	14.5	13.9	10.3
P/BV				4.7	3.8	3.2	2.6
EV/Sales				2.8	2.6	2.3	1.7
EV/EBITDA				12.1	11.2	10.3	7.8
Dividend Yield (%)				0.3	0.3	0.3	0.3
FCF per share				27.0	-12.3	15.6	-30.4
Return Ratios (%)							
RoE	41.6	35.4	32.5	27.6	23.8	20.1	22.0
RoCE	23.3	20.4	20.4	19.0	17.4	15.3	15.9
RoIC	24.2	20.9	22.8	22.5	20.4	18.3	20.3
Working Capital Ratios							
Asset Turnover (x)	1.1	1.3	1.2	1.2	1.0	1.0	0.9
Inventory (Days)	107	109	106	105	130	106	105
Debtor (Days)	116	105	120	85	68	110	110
Creditor (Days)	137	136	146	141	142	132	134
Working Cap. Turnover (Days)	198	140	146	128	145	157	157
Leverage Ratio (x)							
Current Ratio	3.4	2.4	2.5	2.6	2.7	3.3	4.2
Interest Cover Ratio	18	26	30	45	42	39	21
Debt/Equity	1.0	0.7	0.6	0.3	0.4	0.3	0.6

Consolidated - Cash Flow Statement						(INR Million)	
Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
OP/(Loss) before Tax	19,703	22,310	27,443	30,608	32,305	34,131	47,461
Depreciation	3,125	3,326	3,924	4,276	5,580	6,186	8,704
Interest / Dividend recieved	232	808	689	384	1,020	800	500
Direct Taxes Paid	-3,635	-5,966	-7,326	-7,737	-8,183	-8,176	-11,100
(Inc)/Dec in WC	-13,533	-2,515	-10,794	6,110	-12,760	-13,139	-29,238
CF from Operations	5,893	17,963	13,936	33,641	17,962	19,802	16,328
Others	-2,031	-596	262	-856	-168	-682	0
CF from Operating incl EO	3,863	17,367	14,198	32,786	17,795	19,120	16,328
(inc)/dec in FA	-4,656	-14,389	-14,475	-16,942	-25,011	-10,000	-34,150
Free Cash Flow	-793	2,978	-277	15,844	-7,217	9,120	-17,822
(Pur)/Sale of Investments	-25	0	23	-929	657	0	0
CF from Investments	-4,681	-14,388	-14,452	-17,870	-24,355	-10,000	-34,150
Issue of Shares	-910	-386	72	67	318	0	0
(Inc)/Dec in Debt	2,131	2,298	6,033	-17,279	13,982	-3,143	59,339
Interest Paid	-1,079	-843	-835	-568	-777	-865	-2,283
Dividend Paid	-875	-1,314	-1,616	-1,372	-1,465	-1,465	-1,465
Others	1,253	172	-88	1,369	1,983	70	71
CF from Fin. Activity	520	-73	3,566	-17,784	14,042	-5,403	55,662
Inc/Dec of Cash	-298	2,905	3,312	-2,868	7,482	3,717	37,840
Opening Balance	2,085	1,786	4,691	8,003	5,135	12,616	16,334
Closing Balance	1,786	4,691	8,003	5,134	12,616	16,334	54,173

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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