

November 13, 2018

Q2FY19 Result Update

■ Change in Estimates | ■ Target | ■ Reco

Change in Estimates

	Current		Previous	
	FY19E	FY20E	FY19E	FY20E
Rating	BUY		BUY	
Target Price	909		909	
Sales (Rs. m)	1,76,776	1,94,386	1,76,776	1,94,386
% Chng.	-	-	-	-
EBITDA (Rs. m)	39,421	43,348	39,421	43,348
% Chng.	-	-	-	-
EPS (Rs.)	46.1	50.5	46.1	50.5
% Chng.	-	-	-	-

Key Financials

	FY17	FY18	FY19E	FY20E
Sales (Rs. m)	1,48,448	1,62,329	1,76,776	1,94,386
EBITDA (Rs. m)	31,892	35,216	39,421	43,348
Margin (%)	21.5	21.7	22.3	22.3
PAT (Rs. m)	23,017	23,952	27,016	29,593
EPS (Rs.)	39.3	40.9	46.1	50.5
Gr. (%)	13.5	4.1	12.8	9.5
DPS (Rs.)	1.9	-	4.5	4.5
Yield (%)	0.2	-	0.6	0.6
RoE (%)	27.6	22.8	20.8	19.0
RoCE (%)	22.0	20.5	19.2	18.7
EV/Sales (x)	3.3	3.1	2.8	2.6
EV/EBITDA (x)	15.5	14.2	12.7	11.5
PE (x)	20.3	19.5	17.3	15.8
P/BV (x)	5.0	4.0	3.3	2.8

Key Data

ARBN.BO | ARBP IN

52-W High / Low	Rs.827 / Rs.527
Sensex / Nifty	34,813 / 10,482
Market Cap	Rs.466bn / \$ 6,393m
Shares Outstanding	586m
3M Avg. Daily Value	Rs.6571.94m

Shareholding Pattern (%)

Promoter's	51.87
Foreign	19.11
Domestic Institution	15.04
Public & Others	13.98
Promoter Pledge (Rs bn)	5.19

Stock Performance (%)

	1M	6M	12M
Absolute	8.2	30.2	7.5
Relative	8.0	32.9	2.9

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Balanced strategy in US helps in lasting success

ARBP's performance in Q2FY19 were in-line with our estimates as its net sales, adj. EBITDA and PAT increased by 12%, 33% and 34% QoQ respectively. Adjusted with exceptional costs (consultancy for legal and due diligence before acquisition of businesses from Apotex and Sandoz) of Rs268m, PAT grew 38% QoQ in Q2FY19 despite of headwinds in base business due to competitive intensity and price erosions. ARBP provisioned forex loss of Rs387m due to MTM adjustment of its loan portfolio while Rs10m was realized loss due to expiry of forward contract. With guidance of robust pipeline and visibility from the waves of complex generics till FY20E, we expect ARBP's US generics to grow at 10% CAGR in FY18E-20E as price erosion in its portfolio is gradual stabilizing at 6-8%. Near term growth drivers are gWelchol, gErtapenem, gToprol XL, Vancomycin, OTC drugs (10-12 launches) in US and DTG in ARV business. Management also guided for a key launches of an injectable and developed sizeable inventory estimating approval in January CY19. We believe the product could be partner's product in peptide segment as ARBP has agreement for supplying API for partner in US. The stock trades at PE 16.6x of FY19E and 15.2x of FY20E, an attractive discount of 20-25% to the valuation of the peers among the large-cap pharma companies. We maintain BUY and retain TP at Rs909.

Key launches drives US; EU growth takes breather: With launches of limited competition drug Ertapenem, US injectable business was back on track with US\$50m revenues in Q2FY19 and US\$86m in H1FY19. Its injectable growth was tepid in Q1FY19 due to recall of bagline products in May CY18, trimming its US sales by US\$18-20m. Management maintained guidance of 30% YoY growth in US injectable sales to US\$210-215m in FY19E. With launches of 10-12 key drugs, US OTC sales guided to be US\$45-50m in FY19E (vs. US\$16m in FY18), lowering from earlier sales guidance of US\$60m. Maintaining upbeat on the back of US\$318m US sales in Q2FY19, management expects stronger growth in H2FY19E on key launches like gToprol-XL, gPrevacid-ODT, NBO and one injectable (most likely a partner's product in peptide segment). With outperforming EU market growth over several quarters, EU sales increased lower at 4% YoY. EU pharma market average growth was 0-5% YoY vs. ARBP's average growth of 8-10% over years. Management expects to maintain its average growth and double-digit EBITDA margin post manufacturing site transfer of 97 products from EU to India.

Expansion of WC completed; focus on cashing out higher WC: With focus on capturing NBOs (new business opportunities) post withdrawal of products by large peers, ARBP changed working capital (WC) policy by extending inventory (RM+FG) up to 3 months (vs 1.5 months). Besides, it would help to prevent cash outflow on account of penalty payment due to failure to supply committed volume to distributors. Its NBO order books increased to US\$100m of which ~US\$20-25m was realized in Q2FY19. ARBP's free cash flow helped to reduce net debt by US\$20m to US\$551m in Q2FY19. It guided net debt of US\$450m in FY19E and US\$300-350m in FY20E, assuming no additional acquisition costs. Excluding forex impact, its inventory expansion was US\$95m over 6 months.

Exhibit 1: Q2FY19 Financials in brief

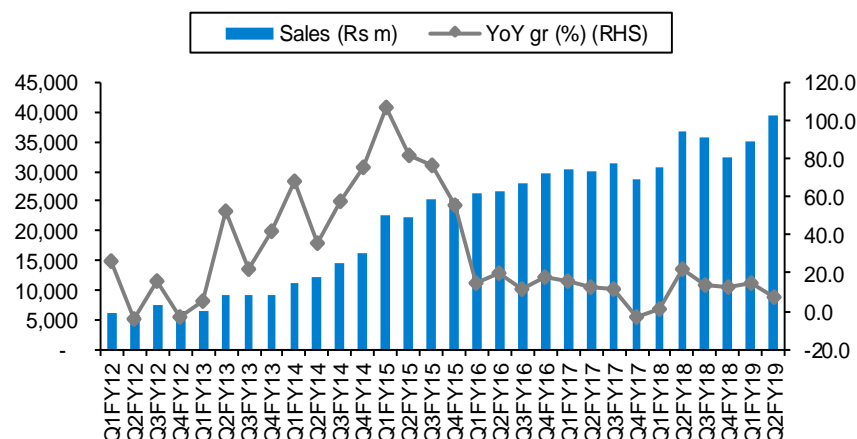
Y/e March	Q2FY19	Q2FY18	YoY gr. (%)	Q1FY19	H1FY19	H1FY18	YoY gr. (%)
Net Sales	46,671	43,542	7.2	41,816	1,76,776	1,62,329	8.9
Raw Material	20,429	17,679	15.6	19,073	75,925	67,527	12.4
<i>% of Net Sales</i>	<i>43.8</i>	<i>40.6</i>		<i>45.6</i>	<i>43.0</i>	<i>41.6</i>	
Personnel Cost	6,255	5,187	20.6	5,961	19,887	21,308	(6.7)
<i>% of Net Sales</i>	<i>13.4</i>	<i>11.9</i>		<i>14.3</i>	<i>11.3</i>	<i>13.1</i>	
Others	10,570	10,319	2.4	9,677	41,542	38,277	8.5
<i>% of Net Sales</i>	<i>22.6</i>	<i>23.7</i>		<i>23.1</i>	<i>23.5</i>	<i>23.6</i>	
Total Expenditure	37,254	33,186	12.3	34,711	1,37,355	1,27,113	8.1
EBITDA	9,417	10,356	(9.1)	7,105	39,421	35,216	11.9
<i>Margin (%)</i>	<i>20.2</i>	<i>23.8</i>		<i>17.0</i>	<i>22.3</i>	<i>21.7</i>	
Depreciation	1,637	1,321	23.9	1,545	6,568	5,580	17.7
EBIT	7,780	9,035	(13.9)	5,560	32,853	29,636	10.9
Other Income	1,105	920	20.2	1,124	3,911	3,690	6.0
Interest	751	177	324.2	977	1,021	945	8.1
PBT	8,135	9,778	(16.8)	5,707	35,743	32,381	10.4
Extra-Ord. Inc./Exps.	266	(13)		(5)	(30)	(34)	
Total Taxes	1,754	1,980	(11.4)	1,155	8,757	8,183	7.0
<i>ETR (%)</i>	<i>21.6</i>	<i>20.2</i>		<i>20.2</i>	<i>24.5</i>	<i>25.3</i>	
Reported PAT	6,114	7,812	(21.7)	4,557	27,016	24,232	11.5

Source: Company, PL

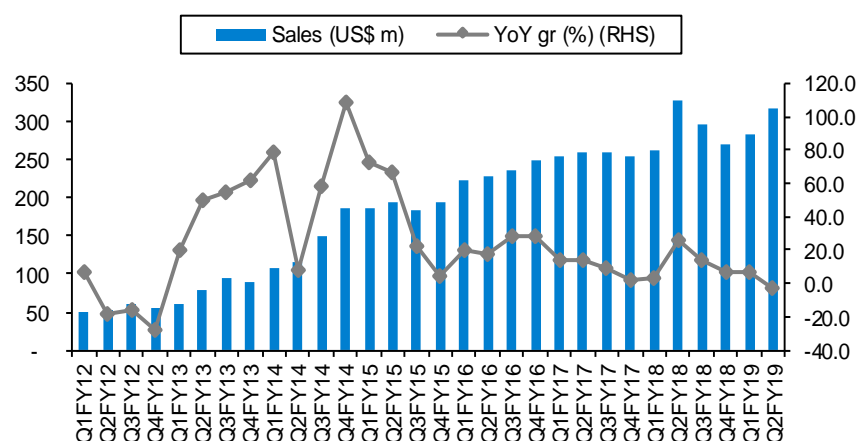
Exhibit 2: Major Sources of Revenue

Major sources of revenues	Q2FY19	Q2FY18	YoY gr. (%)	Q1FY19	H1FY19	H1FY18	YoY gr. (%)
Formulations	39,348	36,633	7.4	35,008	1,46,779	1,35,332	8.5
<i>% of Net Sales</i>	<i>82.8</i>	<i>82.6</i>		<i>82.4</i>	<i>83.0</i>	<i>82.0</i>	
USA	22,268	20,989	6.1	18,896	84,614	74,421	13.7
<i>% of Net Sales</i>	<i>46.9</i>	<i>47.3</i>		<i>44.5</i>	<i>47.9</i>	<i>45.1</i>	
Europe & Emerging Markets	14,640	13,569	7.9	14,556	47,562	52,515	(9.4)
<i>% of Net Sales</i>	<i>30.8</i>	<i>30.6</i>		<i>34.2</i>	<i>26.9</i>	<i>31.8</i>	
ARV	2,440	2,075	17.6	1,556	14,604	8,396	73.9
<i>% of Net Sales</i>	<i>5.1</i>	<i>4.7</i>		<i>3.7</i>	<i>8.3</i>	<i>5.1</i>	
API	8,166	7,718	5.8	7,480	29,971	29,622	1.2
<i>% of Net Sales</i>	<i>17.2</i>	<i>17.4</i>		<i>17.6</i>	<i>17.0</i>	<i>18.0</i>	
Betalactum	5,134	5,142	(0.2)	4,919	19,968	19,923	0.2
<i>% of Net Sales</i>	<i>10.8</i>	<i>11.6</i>		<i>11.6</i>	<i>11.3</i>	<i>12.1</i>	
Non-Betalactum	3,032	2,576	17.7	2,561	10,003	9,699	3.1
<i>% of Net Sales</i>	<i>6.4</i>	<i>5.8</i>		<i>6.0</i>	<i>5.7</i>	<i>5.9</i>	
Dossier Income	-	7	NA	15	25	44	(43.3)
Gross Sales	47,514	44,358	7.1	42,503	1,76,776	1,64,998	7.1

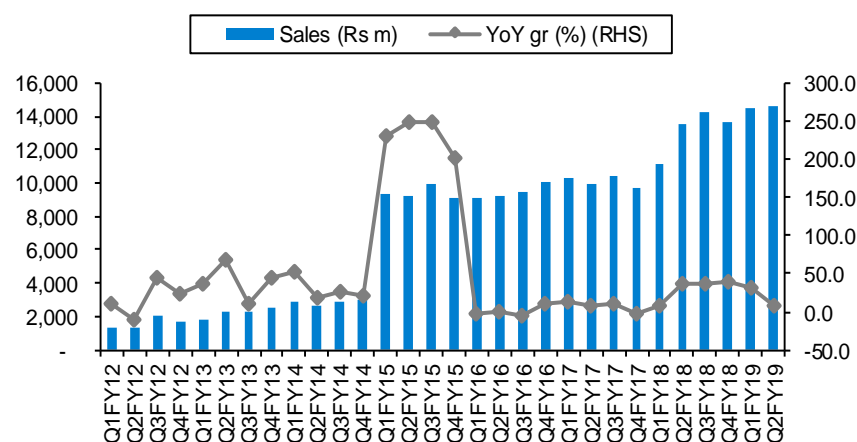
Source: Company, PL

Exhibit 3: Formulation sales & growth


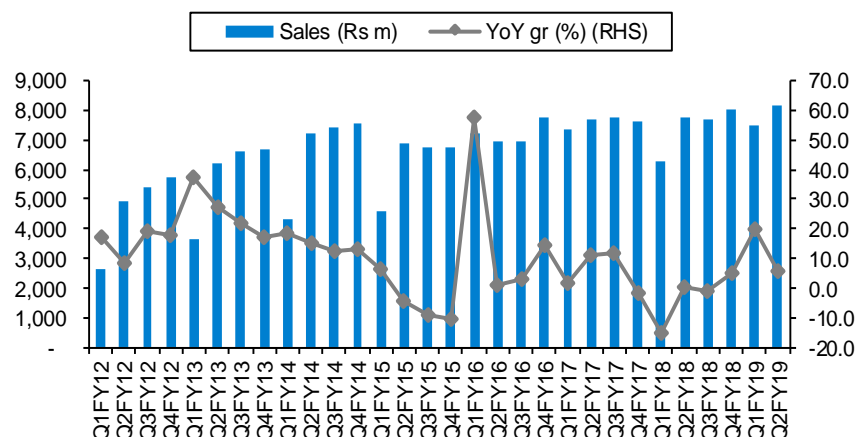
Source: Company, PL

Exhibit 4: US Generics sales (US\$m), growth


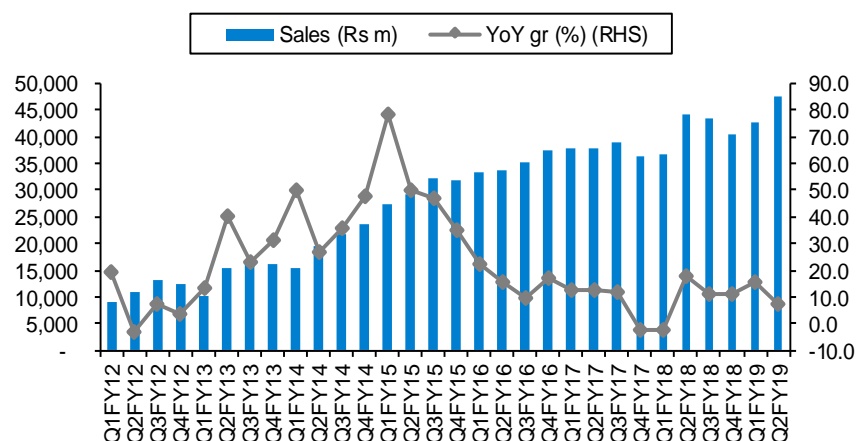
Source: Company, PL

Exhibit 5: EU & ROW sales, growth


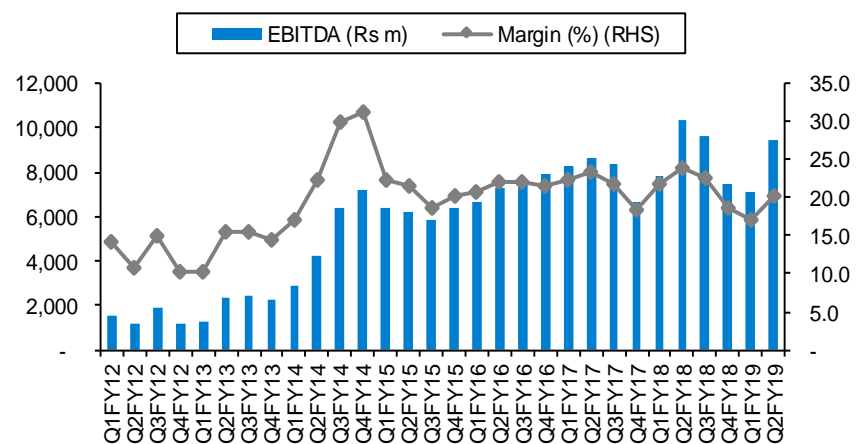
Source: Company, PL

Exhibit 6: API sales, growth


Source: Company, PL

Exhibit 7: Overall sales, growth


Source: Company, PL

Exhibit 8: EBITDA, margin


Source: Company, PL

Financials

Income Statement (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
Net Revenues	1,48,448	1,62,329	1,76,776	1,94,386
YoY gr. (%)	8.3	9.4	8.9	10.0
Cost of Goods Sold	64,343	67,527	75,925	83,489
Gross Profit	84,105	94,801	1,00,851	1,10,897
Margin (%)	56.7	58.4	57.1	57.1
Employee Cost	17,678	21,308	19,887	21,868
Other Expenses	5,430	6,669	10,607	11,663
EBITDA	31,892	35,216	39,421	43,348
YoY gr. (%)	8.4	10.4	11.9	10.0
Margin (%)	21.5	21.7	22.3	22.3
Depreciation and Amortization	4,276	5,580	6,568	7,397
EBIT	27,616	29,636	32,853	35,951
Margin (%)	18.6	18.3	18.6	18.5
Net Interest	667	777	1,021	941
Other Income	3,610	3,690	3,911	4,146
Profit Before Tax	30,558	32,548	35,743	39,156
Margin (%)	20.6	20.1	20.2	20.1
Total Tax	7,596	8,463	8,757	9,593
Effective tax rate (%)	24.9	26.0	24.5	24.5
Profit after tax	22,962	24,086	26,986	29,563
Minority interest	(55)	(34)	(30)	(30)
Share Profit from Associate	-	-	-	-
Adjusted PAT	23,017	23,952	27,016	29,593
YoY gr. (%)	13.7	4.1	12.8	9.5
Margin (%)	15.5	14.8	15.3	15.2
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	23,017	23,952	27,016	29,593
YoY gr. (%)	13.7	4.1	12.8	9.5
Margin (%)	15.5	14.8	15.3	15.2
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	23,017	23,952	27,016	29,593
Equity Shares O/s (m)	586	586	586	586
EPS (Rs)	39.3	40.9	46.1	50.5

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
Non-Current Assets				
Gross Block	52,292	70,638	95,469	1,16,341
Tangibles	47,998	59,555	81,550	1,00,047
Intangibles	4,294	11,083	13,918	16,294
Acc: Dep / Amortization	8,017	13,597	20,165	27,562
Tangibles	7,168	12,189	17,722	23,969
Intangibles	850	1,407	2,443	3,593
Net fixed assets	44,275	57,041	75,303	88,779
Tangibles	40,831	47,366	63,829	76,078
Intangibles	3,444	9,676	11,475	12,701
Capital Work In Progress	14,581	15,830	11,873	6,500
Goodwill	4,063	8,165	8,165	8,165
Non-Current Investments	3,267	4,044	4,276	4,567
Net Deferred tax assets	1,185	(765)	1,483	2,658
Other Non-Current Assets	2,569	2,504	3,130	3,913
Current Assets				
Investments	0	0	0	0
Inventories	43,305	58,584	61,766	65,265
Trade receivables	27,653	30,844	30,512	33,551
Cash & Bank Balance	5,135	12,616	4,215	2,619
Other Current Assets	8,283	11,790	12,969	14,266
Total Assets	1,62,494	2,11,052	2,23,332	2,40,364
Equity				
Equity Share Capital	586	586	586	586
Other Equity	93,133	1,16,218	1,41,908	1,68,416
Total Network	93,719	1,16,804	1,42,494	1,69,001
Non-Current Liabilities				
Long Term borrowings	1,814	4,512	2,256	1,128
Provisions	224	559	698	873
Other non current liabilities	-	-	-	-
Current Liabilities				
ST Debt / Current of LT Debt	31,827	40,313	36,413	33,113
Trade payables	24,883	26,274	26,153	25,563
Other current liabilities	9,513	20,218	14,153	9,550
Total Equity & Liabilities	1,62,494	2,11,052	2,23,332	2,40,364

Source: Company Data, PL Research



Cash Flow (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
PBT	30,558	32,548	35,743	39,156
Add. Depreciation	4,276	5,580	6,568	7,397
Add. Interest	667	777	1,021	941
Less Financial Other Income	3,610	3,690	3,911	4,146
Add. Other	(1,089)	(1,582)	(472)	(1,254)
Op. profit before WC changes	34,413	37,323	42,860	46,240
Net Changes-WC	6,110	(10,405)	(10,504)	(13,379)
Direct tax	(7,737)	(8,267)	(9,829)	(10,768)
Net cash from Op. activities	32,786	18,650	22,526	22,093
Capital expenditures	(16,846)	(19,596)	(20,873)	(15,500)
Interest / Dividend Income	155	158	161	164
Others	(1,179)	(657)	-	-
Net Cash from Invt. activities	(17,870)	(20,095)	(20,712)	(15,336)
Issue of share cap. / premium	67	-	-	-
Debt changes	(17,279)	11,184	(6,156)	(4,428)
Dividend paid	(1,372)	-	(3,085)	(3,085)
Interest paid	(568)	(777)	(1,021)	(941)
Others	(2)	-	-	-
Net cash from Fin. activities	(19,154)	10,407	(10,262)	(8,453)
Net change in cash	(4,239)	8,963	(8,447)	(1,696)
Free Cash Flow	15,940	(945)	1,654	6,593

Source: Company Data, PL Research

Quarterly Financials (Rs m)

Y/e Mar	Q3FY18	Q4FY18	Q1FY19	Q2FY19
Net Revenue	42,690	39,886	41,816	46,671
YoY gr. (%)	11.0	11.3	15.5	7.2
Raw Material Expenses	18,175	16,695	19,073	20,429
Gross Profit	24,515	23,192	22,743	26,242
Margin (%)	57.4	58.1	54.4	56.2
EBITDA	9,585	7,436	7,105	9,417
YoY gr. (%)	(7.4)	(22.4)	(4.4)	32.5
Margin (%)	22.5	18.6	17.0	20.2
Depreciation / Depletion	1,381	1,566	1,545	1,637
EBIT	8,204	5,869	5,560	7,780
Margin (%)	19.2	14.7	13.3	16.7
Net Interest	189	247	295	354
Other Income	1,002	884	443	708
Profit before Tax	9,017	6,506	5,707	8,135
Margin (%)	21.1	16.3	13.6	17.4
Total Tax	3,069	1,224	1,155	1,754
Effective tax rate (%)	34.0	18.8	20.2	21.6
Profit after Tax	5,948	5,282	4,552	6,380
Minority interest	(3)	(3)	(5)	(2)
Share Profit from Associates	-	-	-	-
Adjusted PAT	5,950	5,285	4,557	6,383
YoY gr. (%)	2.8	(0.7)	(12.1)	(18.3)
Margin (%)	13.9	13.3	10.9	13.7
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	5,950	5,285	4,557	6,383
YoY gr. (%)	2.8	(0.7)	(12.1)	(18.3)
Margin (%)	13.9	13.3	10.9	13.7
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	5,950	5,285	4,557	6,383
Avg. Shares O/s (m)	586	586	586	586
EPS (Rs)	10.2	9.0	7.8	10.9

Source: Company Data, PL Research

Key Financial Metrics

Y/e Mar	FY17	FY18	FY19E	FY20E
Per Share(Rs)				
EPS	39.3	40.9	46.1	50.5
CEPS	46.6	50.4	57.3	63.1
BVPS	160.0	199.4	243.2	288.4
FCF	27.2	(1.6)	2.8	11.3
DPS	1.9	-	4.5	4.5
Return Ratio(%)				
RoCE	22.0	20.5	19.2	18.7
ROIC	17.5	14.9	15.0	15.1
RoE	27.6	22.8	20.8	19.0
Balance Sheet				
Net Debt : Equity (x)	0.3	0.3	0.2	0.2
Net Working Capital (Days)	113	142	137	138
Valuation(x)				
PER	20.3	19.5	17.3	15.8
P/B	5.0	4.0	3.3	2.8
P/CEPS	62.7	67.8	77.1	84.9
EV/EBITDA	15.5	14.2	12.7	11.5
EV/Sales	3.3	3.1	2.8	2.6
Dividend Yield (%)	0.2	-	0.6	0.6

Source: Company Data, PL Research

Key Operating Metrics

Y/e Mar	FY17	FY18	FY19E	FY20E
US Formulations	68,272	76,921	84,614	94,507
EU & ROW	40,327	43,536	47,562	52,765
ARV formulations	11,854	13,276	14,604	16,312
APIs	30,420	29,151	29,971	30,776

Source: Company Data, PL Research

Price Chart

Recommendation History



No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	17-Nov-17	BUY	877	713
2	13-Dec-17	BUY	877	669
3	10-Jan-18	BUY	877	673
4	09-Feb-18	BUY	909	602
5	12-Feb-18	BUY	909	590
6	05-Mar-18	BUY	909	601
7	15-Mar-18	BUY	909	573
8	13-Apr-18	BUY	909	620
9	21-May-18	BUY	909	595
10	27-Jun-18	BUY	909	608

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Aurobindo Pharma	BUY	909	757
2	Cadila Healthcare	Accumulate	371	359
3	Cipla	Reduce	417	563
4	Dr. Lal PathLabs	Accumulate	1,009	885
5	Dr. Reddy's Laboratories	Reduce	2,170	2,405
6	Eris Lifesciences	Accumulate	704	643
7	Glenmark Pharmaceuticals	Reduce	472	602
8	Indoco Remedies	Reduce	184	178
9	Ipca Laboratories	BUY	829	642
10	Jubilant Life Sciences	Accumulate	723	650
11	Lupin	Reduce	713	885
12	Sun Pharmaceutical Industries	Reduce	447	599
13	Thyrocare Technologies	BUY	796	550

PL's Recommendation Nomenclature (Absolute Performance)

Buy	: > 15%
Accumulate	: 5% to 15%
Hold	: +5% to -5%
Reduce	: -5% to -15%
Sell	: < -15%
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly

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