

Aurobindo Pharma

BUY

INDUSTRY PHARMA

CMP (as on 13 Nov 2018) Rs 775

Target Price Rs 875

Nifty 10,583
Sensex 35,144

KEY STOCK DATA

Bloomberg ARBP IN
No. of Shares (mn) 586
MCap (Rs bn) / (\$ mn) 454/6,248
6m avg traded value (Rs mn) 2,394

STOCK PERFORMANCE (%)

52 Week high / low Rs 827/527
3M 6M 12M
Absolute (%) 25.2 26.7 9.1
Relative (%) 31.8 27.8 2.7

SHAREHOLDING PATTERN (%)

Promoters 51.9
FIs & Local MFs 15.8
FPIs 17.8
Public & Others 14.5

Source : BSE

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Attractive valuations

Aurobindo Pharma's (ARBP) 2QFY19 performance was ahead of our estimates, with revenue at Rs 47.5bn, up 7/12% YoY/QoQ despite a high base of 2QFY18 which includes gRenvela sales. The 11% beat was primarily driven by the US business (~47% of revenue, up 6/18% YoY/QoQ), while all other segments also grew during the quarter. EBITDA came in at Rs 10.3bn, down 8%YoY/ up 32%QoQ with margin at 21.6% (in-line), expanding 326bps QoQ aided by a 188bps improvement in gross margin (now at 57%), as well as operating leverage. PAT at Rs 6.1bn (-22/+34% YoY/QoQ) was impacted by a one-off acquisition cost amounting to Rs 268mn, adjusting for which it stood at Rs 6.4bn.

We remain bullish on ARBP as the strong launch momentum in the US is maintained, and the European business continues to expand driven by cost competitiveness. Post Sandoz integration, we expect earnings to jump by Rs 14-15/sh over FY20-21E and ARBP will become the 2nd largest generic company in the US. Overall, we estimate 7-8% revenue CAGR (ex-Sandoz) over FY18-21E. Increasing complex generics launches will keep EBITDA margin in the range of 21-22%, despite higher raw material prices. Trading at 14x FY20E EPS, ARBP remains one of the cheapest among

Financial Summary

Year Ending March (Rs mn)	2QFY19	2QFY18	YoY (%)	1QFY19	QoQ (%)	FY18	FY19E	FY20E	FY21E
Net Sales	47,514	44,359	7.1	42,503	11.8	164,998	181,103	259,445	272,542
EBITDA	10,260	11,174	(8.2)	7,792	31.7	37,885	35,568	55,377	60,698
APAT	6,383	7,812	(18.3)	4,557	40.1	24,232	21,982	33,077	35,026
Diluted EPS (Rs)	10.9	13.3	(18.3)	7.8	40.1	41.4	37.5	56.5	59.8
P/E (x)						18.7	20.7	13.7	13.0
RoE (%)						23.0	17.3	21.6	18.9

Source: Company, HDFC sec Inst Research # Consolidated

its large cap peers. Maintain BUY with a TP of Rs 875 (15x Sep'20E EPS).

Highlights of the quarter

- **The US business:** Revenue grew ~11%QoQ (constant currency) driven by new product launches, new business opportunities, and a one-off Valsartan shortage which is expected to continue in 3Q as well. AuroMedics sales at US\$ 50mn grew 39%YoY led by Ertapenem. AuroHealth and Natrol reported revenue of US\$ 11.5mn and US\$ 32.3mn respectively. ARBP filed 25 ANDAs, received 15 approvals, and launched 14 products in the US during the quarter.
- **Other highlights:** (1) EU biz was down due to fewer market opportunities, should grow at single-digits for FY19. (2) ARV segment is doing well, barring DTG which is facing issues due to certain side-effects. (3) Apotex acquisition will be completed by FY19-end. (4) To acquire a DPI product under development from Advent for US\$ 12.5mn. The product is ready to start clinical trials, filing and launch are expected in FY21/23 respectively. (5) Net debt at US\$ 551mn reduced by US\$ 20mn over 1H, to reach US\$ 450mn by FY19-end.
- **Near-term triggers:** Important US product launches.

Revenue growth was led by the formulations segment

Forex loss is on account of restating foreign currency loans (MTM)

R&D expense was Rs 2.2bn (4.6% of revenue) for the quarter

EBITDA margin at 21.6% recovered sequentially, aided by improvement in gross margin

Quarterly Financials Snapshot (Consolidated)

Particulars (Rs mn)	2QFY19	2QFY18	YoY (%)	1QFY19	QoQ (%)
Net Sales	47,514	44,359	7.1	42,503	11.8
Material Expenses	20,429	17,679	15.6	19,073	7.1
Employee Expenses	6,255	5,187	20.6	5,961	4.9
Other Expenses	10,570	10,319	2.4	9,677	9.2
EBITDA	10,260	11,174	(8.2)	7,792	31.7
Depreciation	1,637	1,321		1,545	
EBIT	8,623	9,853	(12.5)	6,247	38.0
Other Income	263	103		437	
Interest Cost	354	173		295	
FX Gains / (Loss)	(397)	(4)		(682)	
Exceptional Items	(268)	-		-	
PBT	7,866	9,778	(19.6)	5,707	37.8
Tax	1,754	1,980		1,155	
Minority Interest	2	13		5	
RPAT	6,114	7,812	(21.7)	4,557	34.2
EO Items (Adj For Tax)	268	-		-	
APAT	6,383	7,812	(18.3)	4,557	40.1

Source: Company, HDFC sec Inst Research

Margin Analysis

	2QFY19	2QFY18	YoY (%)	1QFY19	QoQ (%)
Material Expenses % Net Sales	43.0	39.9	314	44.9	(188)
Employee Expenses % Net Sales	13.2	11.7	147	14.0	(86)
Other Expenses % Net Sales	22.2	23.3	(102)	22.8	(52)
EBITDA Margin (%)	21.6	25.2	(360)	18.3	326
Tax Rate (%)	22.3	20.2	206	20.2	206
APAT Margin (%)	13.4	17.6	(418)	10.7	271

Source: Company, HDFC sec Inst Research

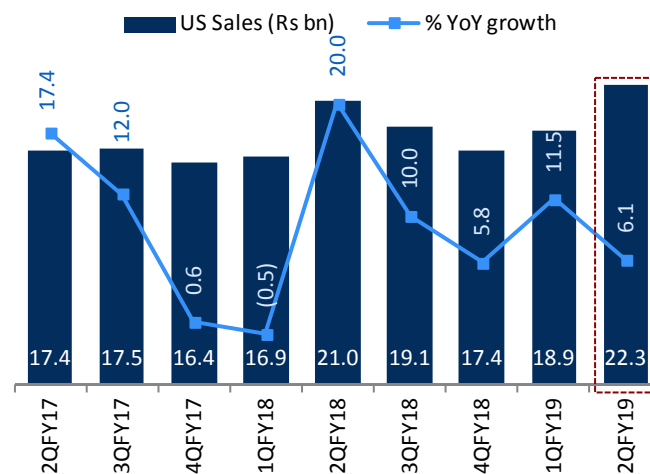
US revenue saw muted YoY performance (down 3% in constant currency) due to a high base of 2QFY18

Management is confident on growing at double the market rate (0-5%) in EU

API growth was driven by the non-betalactum segment

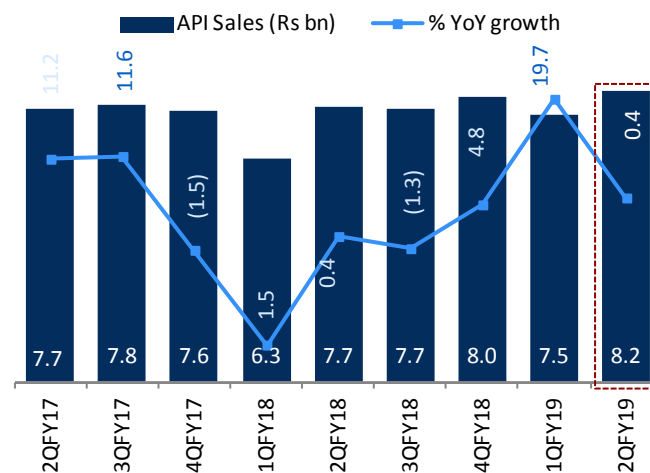
While Chinese API price hike continues to impact raw material cost, ARBP has managed to expand margins to some extent

US Formulations: Aided By Favourable Currency



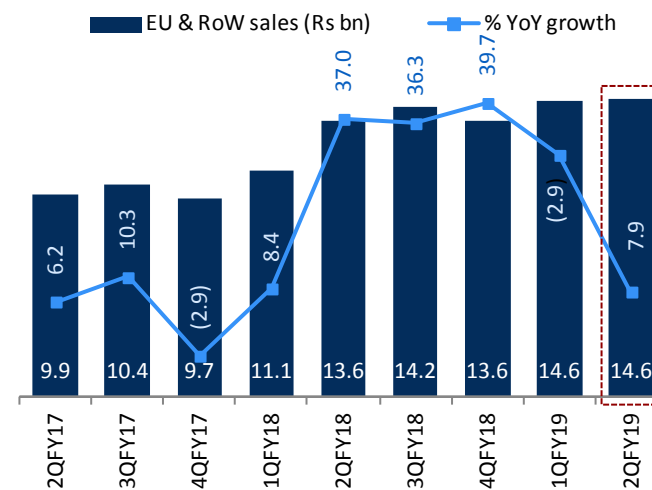
Source: Company, HDFC sec Inst Research

API Revenues: Steady Growth



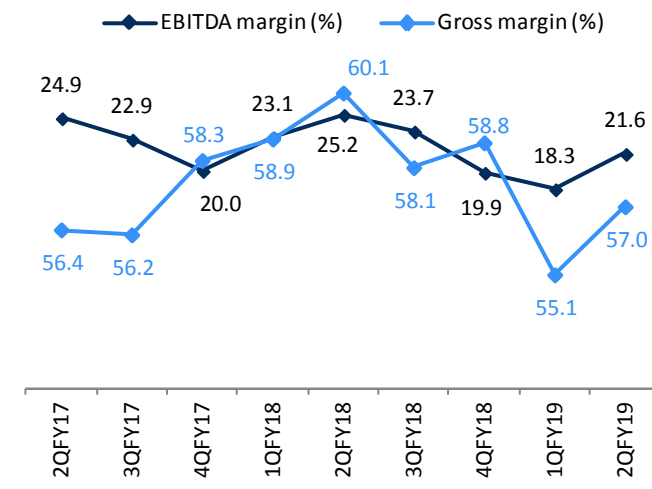
Source: Company, HDFC sec Inst Research

EU Sales declined 3.6%YoY In Constant Currency



Source: Company, HDFC sec Inst Research

Margins Recovered Sequentially



Source: Company, HDFC sec Inst Research

Sequential growth in the US was driven by new business opportunities, Valsartan shortage, and new launches

*Management continues to rationalize products in EU and bring more products to India in order to improve profitability
Currently, 97 products have been moved to India*

There has been some delay in DTG due to the product's side-effects on pregnant women, should be resolved soon

Apotex acquisition will be completed by FY19-end, which will lead to further growth in EU

Segmental Quarterly Performance

(Rs mn)	2QFY19	2QFY18	YoY (%)	1QFY19	QoQ (%)
US	22,268	20,989	6.1	18,896	17.8
Europe & RoW	14,640	13,569	7.9	14,556	0.6
ARVs	2,440	2,075	17.6	1,556	56.8
Formulation (sub-total)	39,348	36,633	7.4	35,008	12.4
Betalactum	5,134	5,142	(0.2)	4,919	4.4
Non Betalactum	3,032	2,576	17.7	2,561	18.4
APIs (sub-total)	8,166	7,718	5.8	7,480	9.2
Dossier Income	-	7	(100.0)	15	(100.0)
Total	47,514	44,358	7.1	42,503	11.8

Source: HDFC sec Inst Research

Assumptions

(Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
US	68,272	74,421	83,413	153,583	157,693
<i>Growth (%)</i>	<i>12.3</i>	<i>9.0</i>	<i>12.1</i>	<i>84.1</i>	<i>2.7</i>
Europe	32,771	43,544	47,898	52,688	57,957
<i>Growth (%)</i>	<i>4.7</i>	<i>32.9</i>	<i>10.0</i>	<i>10.0</i>	<i>10.0</i>
ARV	11,854	8,396	8,396	9,236	10,159
<i>Growth (%)</i>	<i>(2.0)</i>	<i>(29.2)</i>	<i>-</i>	<i>10.0</i>	<i>10.0</i>
RoW	7,556	8,971	10,182	11,557	13,117
<i>Growth (%)</i>	<i>16.9</i>	<i>18.7</i>	<i>13.5</i>	<i>13.5</i>	<i>13.5</i>
API	30,420	29,622	31,213	32,382	33,615
<i>Growth (%)</i>	<i>5.5</i>	<i>(2.6)</i>	<i>5.4</i>	<i>3.7</i>	<i>3.8</i>
Total	150,873	164,954	181,103	259,445	272,542
<i>Growth (%)</i>	<i>8.2</i>	<i>9.3</i>	<i>9.8</i>	<i>43.3</i>	<i>5.0</i>

Source: HDFC sec Inst Research

Peer Set Comparison

	Mcap (Rs bn)	CMP (Rs/sh)	Reco	TP/FV	Adj EPS (Rs/sh)				P/E (x)				RoE (%)			
					FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E
Sun Pharma	1,348	562	BUY	670	13.0	16.7	22.0	28.0	43.2	33.6	25.4	20.0	8.3	10.1	12.2	13.9
Aurobindo Pharma	454	775	BUY	875	41.4	37.5	56.5	59.8	18.7	20.7	13.7	13.0	23.0	17.3	21.6	18.9
Cipla	425	528	NEU	605	17.6	18.7	23.7	31.3	30.0	28.2	22.3	16.9	10.6	10.2	11.7	13.8
Divi's Labs	406	1,531	SELL	1,345	32.4	50.4	57.1	65.1	47.3	30.4	26.8	23.5	15.2	20.9	20.5	20.3
Dr Reddy's Labs	404	2,435	BUY	2,825	59.2	92.1	107.2	149.0	41.2	26.4	22.7	16.3	7.8	11.5	11.9	14.2
Lupin	386	854	BUY	1,030	38.0	27.9	38.7	55.2	22.5	30.6	22.0	15.5	12.7	9.0	11.6	14.9
Cadila Healthcare	364	355	BUY	475	13.0	17.3	20.6	22.8	27.3	20.5	17.2	15.6	17.0	18.5	18.6	17.6
Torrent Pharma	286	1,690	BUY	1,800	40.1	47.7	67.1	96.0	42.2	35.4	25.2	17.6	15.1	16.4	20.0	24.1
Alkem Laboratories	235	1,970	BUY	2,415	57.6	74.4	96.2	123.1	34.2	26.5	20.5	16.0	14.8	17.1	19.2	21.0
Glenmark	191	676	BUY	800	17.5	28.6	35.9	47.3	38.7	23.7	18.8	14.3	9.4	13.5	14.9	17.0
Jubilant Life Sciences	121	758	BUY	980	45.5	54.3	63.8	79.2	16.6	14.0	11.9	9.6	19.3	19.3	19.1	19.9
Alembic Pharma	112	592	NEU	610	21.9	24.2	29.4	38.5	27.0	24.5	20.1	15.4	20.0	18.7	19.2	21.2
Strides Pharma Science	41	461	BUY	480	12.7	4.1	22.3	37.3	36.2	111.0	20.7	12.4	2.7	2.1	7.7	11.9
Laurus Labs	39	365	NR	505	15.7	10.0	23.1	35.0	23.2	36.5	15.8	10.4	11.9	7.0	14.5	18.7
Dishman Carbogen Amcis	37	227	BUY	350	13.2	16.1	20.9	26.6	17.2	14.1	10.9	8.5	4.3	5.0	6.2	7.6
Suven Life Sciences	32	253	NR	450	9.7	9.8	11.0	12.5	26.0	25.8	23.1	20.2	17.2	15.2	15.0	15.2
Granules India	27	105	BUY	140	5.2	8.4	10.6	13.3	20.1	12.5	10.0	7.9	12.0	15.4	17.0	18.4
Neuland Labs	7	550	BUY	835	11.0	15.5	51.8	67.2	50.2	35.5	10.6	8.2	2.2	3.2	9.1	10.8

Source: HDFC sec Inst Research

Change In Estimates (Consolidated)

Rs mn	Previous			New			% Chg		
	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E
Net Sales	164,998	175,252	252,948	164,998	181,103	259,445	0.0	3.3	2.6
EBITDA	37,885	35,751	55,396	37,885	35,568	55,377	0.0	(0.5)	(0.0)
APAT	24,232	22,387	33,187	24,232	21,982	33,077	0.0	(1.8)	(0.3)

Source: HDFC sec Inst Research

Income Statement (Consolidated)

Year ending March (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Net Revenues	149,295	164,998	181,103	259,445	272,542
Growth (%)	8.1	10.5	9.8	43.3	5.0
Material Expenses	64,343	67,527	77,874	106,372	109,017
Employee Expenses	17,678	21,308	24,268	36,322	37,883
SG&A Expenses	11,190	12,638	11,772	17,642	19,078
Other Operating Expenses	21,742	25,640	31,621	43,731	45,866
EBITDA	34,343	37,885	35,568	55,377	60,698
EBITDA Margin (%)	23.0	23.0	19.6	21.3	22.3
EBITDA Growth (%)	7.7	10.3	(6.1)	55.7	9.6
Depreciation	4,276	5,580	6,433	10,473	12,685
EBIT	30,067	32,306	29,135	44,904	48,012
Other Income (Including EO Items)	538	1,020	1,050	1,050	1,150
Interest	667	777	1,279	2,439	3,083
PBT	29,938	32,548	28,905	43,514	46,080
Tax (Incl Deferred)	7,596	8,183	6,937	10,443	11,059
RPAT	22,341	24,365	21,968	33,071	35,021
Minority Interest	(55)	(34)	(14)	(6)	(5)
EO (Loss) / Profit (Net Of Tax)	(621)	168	-	-	-
APAT	23,017	24,232	21,982	33,077	35,026
APAT Growth (%)	13.7	5.3	(9.3)	50.5	5.9
Adjusted EPS (Rs)	39.3	41.4	37.5	56.5	59.8

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

As at March (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
SOURCES OF FUNDS					
Share Capital - Equity	586	586	586	586	586
Reserves	93,133	116,218	136,736	168,348	201,909
Total Shareholders Funds	93,719	116,804	137,322	168,934	202,495
Minority Interest	21	18	19	19	19
Long Term Debt	1,814	4,512	3,384	65,538	47,187
Short Term Debt	29,027	40,313	37,088	33,379	30,042
Total Debt	30,841	44,825	40,472	98,917	77,229
Net Deferred Taxes	(1,185)	765	780	796	812
Other Non-Current Liabilities & Provns	224	450	550	550	550
TOTAL SOURCES OF FUNDS	123,621	162,863	179,143	269,216	281,104
APPLICATION OF FUNDS					
Net Block	44,275	58,876	72,443	102,970	108,285
CWIP	15,596	13,995	8,500	9,500	6,500
Goodwill	4,063	8,165	8,165	50,165	50,165
Investments	2,459	3,115	3,115	3,115	3,115
Other Non-current Assets	2,363	2,995	3,425	7,250	7,825
Total Non-current Assets	68,755	87,148	95,649	173,001	175,890
Cash & Equivalents	12,524	20,494	1,819	1,581	1,061
Inventories	43,305	58,584	59,739	78,686	83,629
Debtors	27,653	30,844	52,098	56,865	63,469
Other Current Assets	8,580	12,395	20,325	24,000	25,175
Total Current Assets	79,538	101,822	132,162	159,551	172,273
Creditors	24,883	26,274	29,888	41,327	42,570
Other Current Liabilities & Provns	12,313	20,327	20,600	23,590	25,550
Total Current Liabilities	37,196	46,601	50,488	64,917	68,120
Net Current Assets	42,342	55,221	81,674	94,634	104,153
TOTAL APPLICATION OF FUNDS	123,621	162,863	179,143	269,216	281,104

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Reported PBT	30,608	32,412	27,855	42,464	44,930
Non-operating & EO items	(732)	(858)	1	10	11
Interest expenses	545	629	1,279	2,439	3,083
Depreciation	4,276	5,580	6,433	10,473	12,685
Working Capital Change	5,825	(10,690)	(26,783)	(16,784)	(10,094)
Tax Paid	(7,737)	(7,524)	(6,922)	(10,428)	(11,045)
OPERATING CASH FLOW (a)	32,786	19,548	1,864	28,174	39,570
Capex	(16,846)	(12,406)	(14,505)	(84,000)	(15,000)
Free cash flow (FCF)	15,940	7,142	(12,640)	(55,826)	24,570
Investments	(1,179)	(7,442)	-	-	-
Non-operating Income	155	279	1,050	1,050	1,150
INVESTING CASH FLOW (b)	(17,870)	(19,570)	(13,455)	(82,950)	(13,850)
Debt Issuance/(Repaid)	(17,279)	12,022	(4,353)	58,445	(21,689)
Interest Expenses	(568)	(742)	(1,279)	(2,439)	(3,083)
FCFE	(2,932)	11,259	(17,223)	1,230	948
Share Capital Issuance	67	2	-	-	-
Dividend	(1,372)	(2,641)	(1,465)	(1,465)	(1,465)
Others	9,326	(650)	13	(3)	(4)
FINANCING CASH FLOW (c)	(9,827)	7,992	(7,084)	54,538	(26,240)
NET CASH FLOW (a+b+c)	5,088	7,970	(18,675)	(238)	(520)
Closing Cash & Equivalents	12,523	20,494	1,819	1,581	1,061

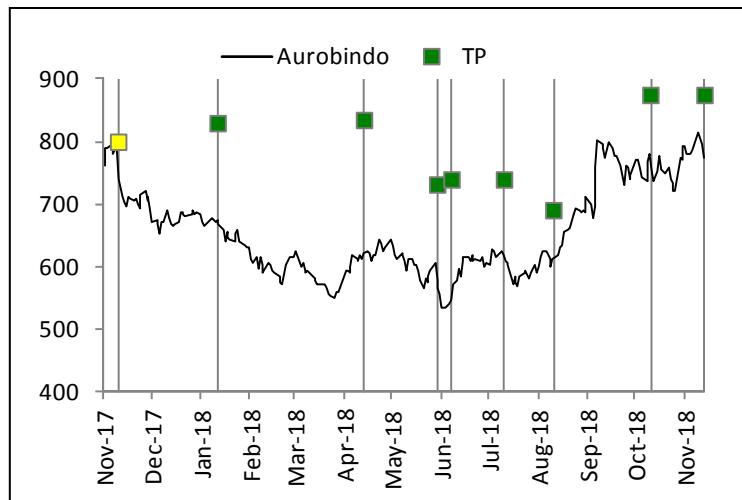
Source: Company, HDFC sec Inst Research

Key Ratios

	FY17	FY18	FY19E	FY20E	FY21E
PROFITABILITY (%)					
GPM	56.9	59.1	57.0	59.0	60.0
EBITDA Margin	23.0	23.0	19.6	21.3	22.3
APAT Margin	15.4	14.7	12.1	12.7	12.9
RoE	27.6	23.0	17.3	21.6	18.9
RoIC (or Core RoCE)	21.3	19.9	14.4	15.9	13.9
RoCE	19.7	17.3	13.4	15.6	13.6
EFFICIENCY					
Tax Rate (%)	25.4	25.1	24.0	24.0	24.0
Fixed Asset Turnover (x)	2.9	2.3	2.0	1.9	1.8
Inventory (days)	105.9	129.6	120.4	110.7	112.0
Debtors (days)	67.6	68.2	105.0	80.0	85.0
Other Current Assets (days)	21.0	27.4	41.0	33.8	33.7
Payables (days)	60.8	58.1	60.2	58.1	57.0
Other Current Liab & Provns (days)	30.1	45.0	41.5	33.2	34.2
Cash Conversion Cycle (days)	103.5	122.2	164.6	133.1	139.5
Debt/EBITDA (x)	0.9	1.2	1.1	1.8	1.3
Net D/E (x)	0.2	0.2	0.3	0.6	0.4
Interest Coverage (x)	45.1	41.6	22.8	18.4	15.6
PER SHARE DATA (Rs)					
EPS	39.3	41.4	37.5	56.5	59.8
Dividend	2.0	3.8	2.5	2.5	2.5
Book Value	160.0	199.4	234.4	288.3	345.6
VALUATION					
P/E (x)	19.7	18.7	20.7	13.7	13.0
P/BV (x)	4.8	3.9	3.3	2.7	2.2
EV/EBITDA (x)	13.8	12.6	13.9	10.0	8.7
EV/Revenues (x)	3.2	2.9	2.7	2.1	1.9
OCF/EV (%)	6.9	4.1	0.4	5.1	7.5
FCF/EV (%)	3.4	1.5	(2.6)	(10.1)	4.6
FCFE/Mkt Cap (%)	(0.6)	2.5	(3.8)	0.3	0.2
Dividend Yield (%)	0.3	0.5	0.3	0.3	0.3

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
11-Nov-17	740	NEU	800
11-Jan-18	675	BUY	830
13-Apr-18	610	BUY	835
29-May-18	579	BUY	732
13-Jun-18	596	BUY	740
10-Jul-18	623	BUY	740
11-Aug-18	610	BUY	691
10-Oct-18	736	BUY	875
14-Nov-18	775	BUY	875

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

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