

Sector: Pharmaceuticals
Result Update

	Change
Reco: Hold	↔
CMP: Rs. 598	
Price Target: Rs. 710	↔

↑ Upgrade ↔ No change ↓ Downgrade

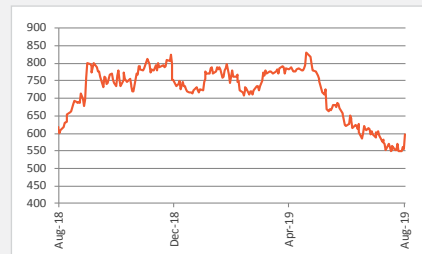
Company details

Market cap:	Rs. 35,037 cr
52-week high/low:	Rs. 838/537
NSE volume: (No of shares)	26.6 lakh
BSE code:	524804
NSE code:	AUOPHARMA
Sharekhan code:	AUOPHARMA
Free float: (No of shares)	28.2 cr

Shareholding (%)

Promoters	51.9
FII	22.0
DII	13.7
Others	12.40

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-7.1	-28.0	-28.6	-10.1
Relative to Sensex	-0.3	-25.5	-28.7	-8.9

Sharekhan Research, Bloomberg

Aurobindo Pharma Limited (Aurobindo) reported a strong set of numbers in Q1FY2020. Sales rose by a strong 28.1% y-o-y to Rs 5,444.6 crore (6% above our estimates), driven by strong growth in formulation business across geographies. Operating profit increased by 47.1% y-o-y to Rs. 1,146.4 crore (15.3% above our estimates). Gross margin improved by 270 bps y-o-y to 57.8%. OPM improved by 272 bps y-o-y to 21.1% (168 bps above our estimate of 19.4%). Adjusted PAT grew by 22.1% y-o-y to Rs. 638.9 crore (7.9% above our estimate). Profitability growth was dented as compared to operating profit growth due to lower other income, high interest and depreciation cost and a higher tax rate.

Key positives

- Gross debt reduced by ~ Rs 1,084 crore (to Rs. 5883.2 crore), on account of strong sales which lead to decline in working capital requirement. Net debt reduced by Rs. 915 crore to Rs. 4,094 crore.
- Gross margin improved by 270 bps y-o-y to 57.8 %. OPM improved 272 bps y-o-y to 21.1% (168 bps above our estimate of 19.4%).
- New products and increase in volumes for existing products led to strong quarterly performance.

Key negatives

- USFDA regulatory hurdles at three API units and two formulation units remain an overhang.

Our Call

Valuation - Maintain Hold with unchanged TP of Rs 710: Although existing businesses may not be affected by the warning letter issued (for Unit- XI), approval for future filings done from these plants could get delayed. Moreover, remediation and site transfer-related costs and integration of acquisitions could stress the company's margins in the near term. However, on the back of strong quarterly numbers, we maintain our earnings estimates for FY2020E and FY2021E. We expect the company to report sales and profit CAGRs of 29% and 22%, respectively, in the next two years. We feel the uncertainty related to regulatory hurdles at various units will weigh on the stock (until resolved successfully). We would like to monitor the sustainability of Q1 performance before taking a constructive view to upgrade the stock rating. Thus we maintain our Hold rating on the stock with an unchanged price target (PT) of Rs. 710.

Key Risks

Delay in product approvals; change in regulatory landscape; negative outcome of key facility inspection by the USFDA can affect earnings prospects.

Valuation (Consolidated)

	Rs cr			
Particulars	FY2018	FY2019	FY2020E	FY2021E
Total Income	16499.8	19563.6	29004.5	32456.3
OPM (%)	23.0	20.2	20.0	20.0
Adj. PAT	2440	2513	3212	3762
EPS (Rs)	41.6	42.9	54.8	64.2
PER (x)	14.4	13.9	10.9	9.3
EV/Ebitda (x)	10.5	10.5	7.1	6.2
P/BV (x)	3.0	2.5	2.0	1.7
D: E	0.51	0.61	0.49	0.40
ROCE (%)	21.9	16.8	19.9	19.3
RONW (%)	23.2	19.7	20.7	19.8

Source: Company, Sharekhan Estimates

Regulatory risks persist

Aurobindo received a warning letter for its Unit-XI, an active pharmaceutical ingredient (API) unit in Srikakulam, one of the three plants that received Official Action Indicated (OAI) status in May 2019. As per the management, the main reason for the warning letter is the ongoing issue pertaining to impurities in Sartan's. The company expects to resolve these with the USFDA and plans to submit a full response by the end of CY2019, after which the USFDA shall re-inspect the units.

Regulatory status of various units under FDA scrutiny

Units	Manufactures	USFDA Status	Inspection Time
API			
Unit I	API	OAI (6 observations)	Jan-19
Unit IX	Intermediates	OAI (5 observations)	Jan-19
Unit XI	API	OAI (3 observations); Warning Letter in Jun-19	Feb-19
Formulation			
Bachupally Unit - III	Oral Formulations	Form 483 with 10 obs	May-19
Telangana Unit - XVI	Sterile formulations	Form 483 with 11 obs	Feb-19

Source: Company, Sharekhan Research, Industry Reports

Integration of newly-acquired assets crucial; rise in margin could be restricted

Aurobindo in past six months has done a series of acquisitions (funded by debt), namely R&D assets in Australia (for \$million12.5 million), units of Sandoz (for \$900mn) and Apotex (for \$82million) with a total consideration value of ~US\$1bn. The acquired portfolio of Sandoz is expected to generate over \$0.9 billion in sales for the first 12 months after completion of the transaction for Aurobindo, before any potential (Federal Trade Commission) FTC-led divestments. The acquisitions are yet to be completed and a successful integration would be crucial for a short-to-mid-term perspective. **We believe that until completion of the acquisitions, a rise in margins and profitability could be restricted by the increase in expenses, interest costs (as acquisitions will be funded by debt) and depreciation (due to assets bought). Also, remediation and site transfer costs are likely to put pressure on near-term margins.**

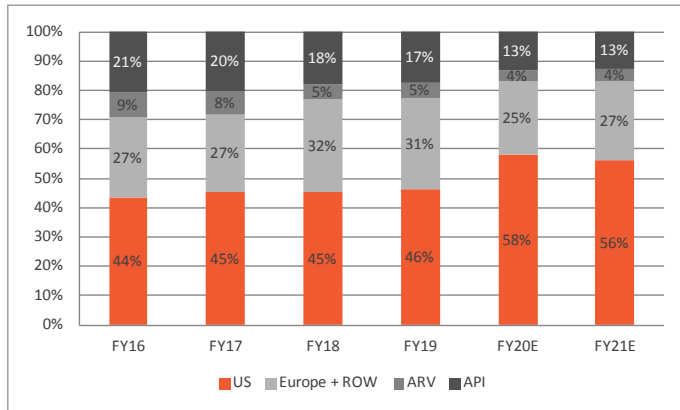
Results

Particulars	Q1FY2020	Q1FY2019	y-o-y %	Q4FY2019	Rs cr QoQ%
Total Income	5444.6	4250.3	28.1	5292.2	2.9%
Operating expenditure	4298.2	3471.1	23.8	4231.9	1.6%
Operating profit	1146.4	779.3	47.1	1060.3	8.1%
Other income	11.0	43.7	-74.8	32.3	-65.9%
EBIDTA	1157.4	823.0	40.6	1092.6	5.9%
Interest	49.9	29.5	68.9	50.1	-0.4%
Depreciation	240.9	154.5	55.9	186.6	29.1%
PBT	866.7	638.9	35.6	855.9	1.3%
Tax	227.8	115.5	97.1	231.1	-1.5%
Adjusted PAT (Ex forex)	638.9	523.4	22.1	624.8	2.3%
Except. Item	0.1	-67.7		-36.5	
Reported PAT	639.0	455.7	40.2	588.2	8.6%
Adj. EPS (Rs)	10.9	8.9	22.1	10.7	2.3%
Reported EPS (Rs)	10.9	7.8	40.2	10.1	8.6%
			bps		bps
OPM (%)	21.1	18.3	272	20.0	102
Adj PAT margin	11.7	12.3	-58	11.8	-7
Tax rate	26.3	18.1	820	27.0	-72

Source: Sharekhan Research

Financials in charts

Sales Mix



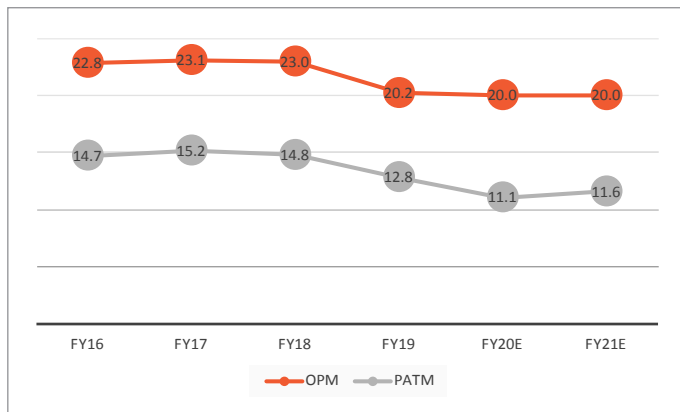
Source: Company, Sharekhan Research

5-year sales CAGR



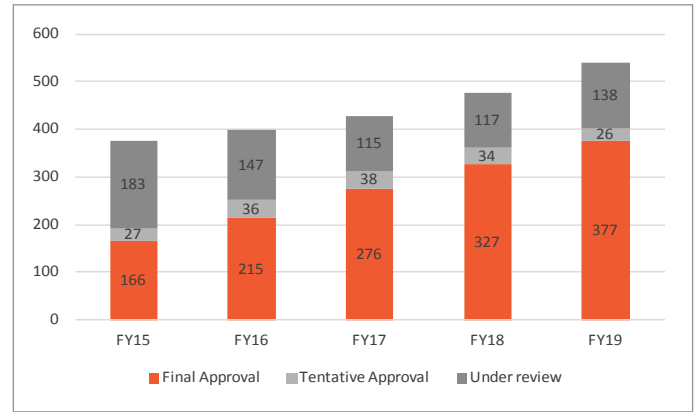
Source: Company, Sharekhan Research

Margin Profile



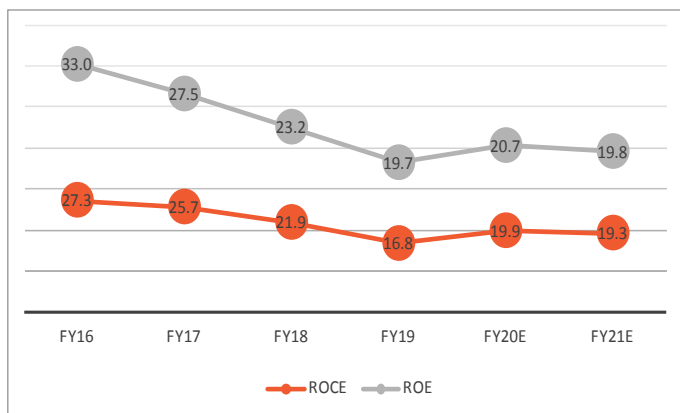
Source: Company, Sharekhan Research

US Filing Snapshot



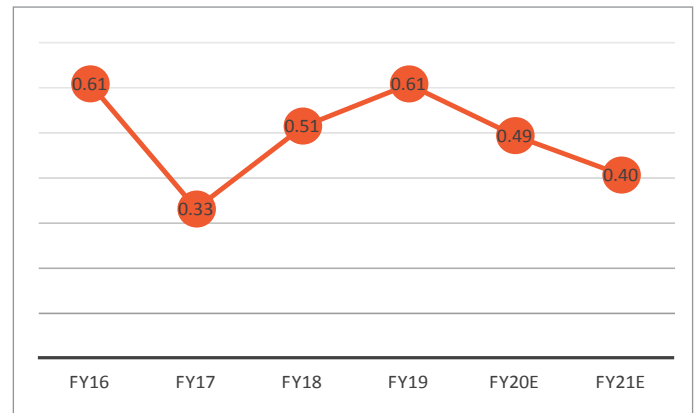
Source: Company, Sharekhan Research

Return Ratios



Source: Company, Sharekhan Research

Improving Debt: Equity Ratio

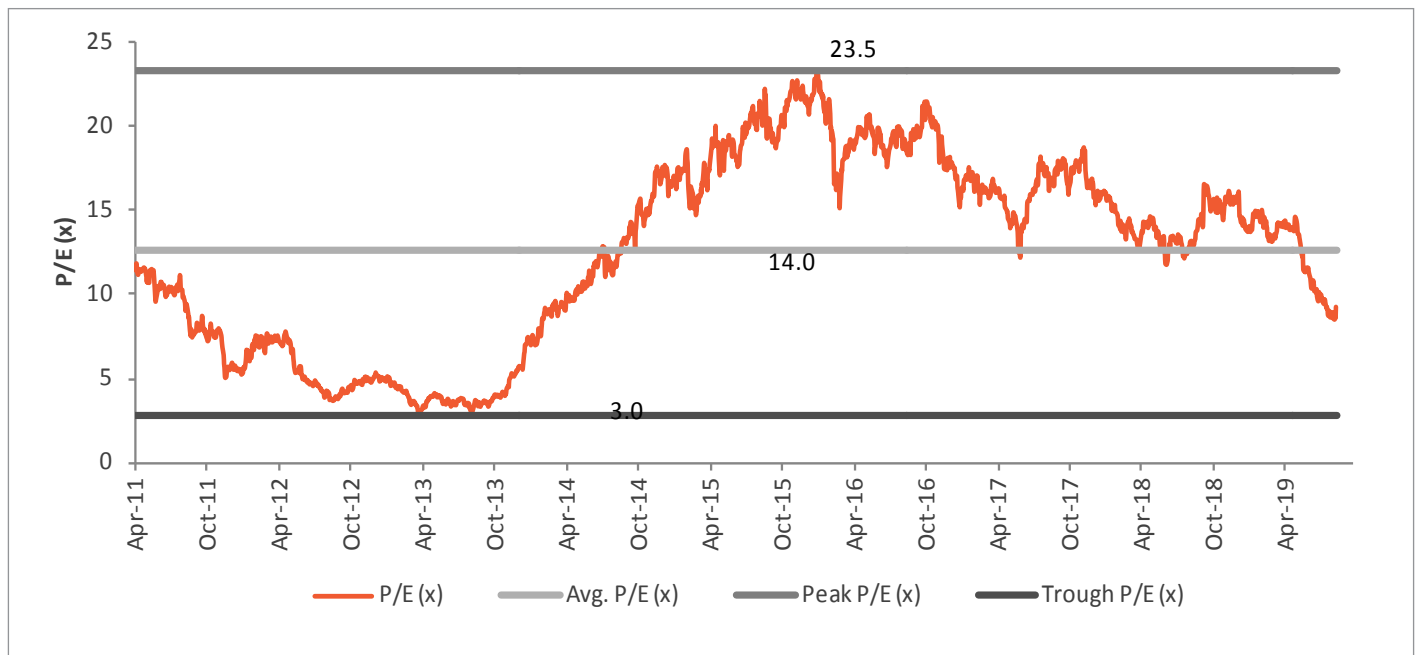


Source: Company, Sharekhan Research

Outlook & Valuation - Maintain Hold with unchanged TP of Rs 710

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One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)		EV/EBIDTA (x)		RoE (%)		D: E	
	FY20E	FY21E	FY20E	FY2021E	FY20E	FY21E	FY20E	FY21E
Aurobindo	10.9	9.3	6.7	5.8	20.7	19.8	0.50	0.40
Cadila	13.0	11.5	9.4	8.2	15.8	15.8	0.80	0.70
Cipla	18.1	12.7	11.9	8.7	12.8	15.4	0.25	0.18
Lupin	27.1	21.7	10.4	8.4	7.2	8.2	0.54	0.48
Torrent Pharma	28.5	17.8	11.3	7.9	11.7	13.9	0.21	0.17

Source: Sharekhan Research

About company

Hyderabad-based Aurobindo Pharma was incorporated in 1986 and manufactures generic formulations and active pharmaceutical ingredients (APIs). Aurobindo generates 90% of its sales from international markets. It currently holds a strong position in the US, where it is the fifth largest generic pharmaceutical company as per the IMS National Prescription Audit, measured by total prescriptions dispensed for the twelve months ending June 2018. It also holds a strong position in many European countries, including France and Italy, where it ranks among the largest generic companies. It is a vertically integrated company, meeting around 70% of its API requirements in-house. Aurobindo has 26 manufacturing facilities for its API and formulations businesses, which have requisite approvals from various regulatory authorities including the US FDA, UK MHRA, Japan PMDA, WHO, Health Canada, MCC South Africa and ANVISA Brazil. Recently, Aurobindo entered Poland and the Czech Republic with the acquisition of Apotex's commercial operations. The company also strengthened its US presence with acquisition of dermatology and oral solid businesses from Sandoz.

Investment theme

Aurobindo has one of the best product approval rates and launch pipelines in the US. Despite pricing pressures, it is one of the few companies, which is able to mitigate this risk to due to continuous product launches and approvals. Besides a strong pipeline is a low product concentration. Going ahead, progress of injectable launches is likely to sustain and be one of the key growth drivers.

Key Risks

Delay in product approvals; change in regulatory landscape; negative outcome of key facility inspections by the US FDA can affect earnings prospects.

Additional Data

Key management personnel

K Nithyananda Reddy	Vice - Chairman, Whole-time Director, One of the promoter.
N Govindarajan	Managing Director
P.V. Ramaprasad Reddy	Non-executive Director, Promoter
Santhanam Subramanian	CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Rani Penaka Suneela	33.52
2	HDFC Asset Management Co Ltd	6.72
3	Reddy K Nithyananda	4.33
4	Reddy Kambam Kirthi	3.53
5	Reddy P V Ramaprasad	3.07
6	Penaka Venkata Ramaprasad	3.07
7	Axis Clinicals Ltd	2.97
8	Sivakumaran M	2.47
9	Vanguard Group Inc.	1.66
10	SBI Funds Management Pvt Ltd	1.62

Source: Bloomberg

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