

Sector: Pharmaceuticals

Result Update

	Change
Reco: Hold	↔
CMP: Rs. 881	
Price Target: Rs. 975	↑

↑ Upgrade ↔ No change ↓ Downgrade

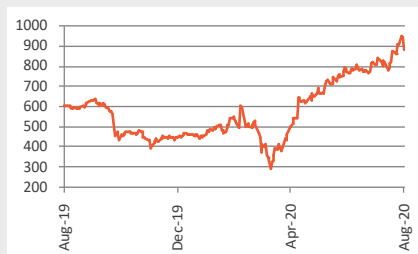
Company details

Market cap:	Rs. 51,639 cr
52-week high/low:	Rs. 968/281
NSE volume: (No of shares)	66.8 lakh
BSE code:	524804
NSE code:	AUROPHARMA
Sharekhan code:	AUROPHARMA
Free float: (No of shares)	28.1 cr

Shareholding (%)

Promoters	52.0
FII	22.8
DII	12.6
Others	12.66

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.9	30.3	67.2	46.1
Relative to Sensex	4.5	10.6	74.8	42.4

Sharekhan Research, Bloomberg

Aurobindo Pharma Limited (Aurobindo) reported mixed set of results for Q1FY2021. Sales rose by 8.8% y-o-y to Rs. 5,925 crore, in line with estimates. Revenues growth was led by a 9% rise in formulations sales, while API sales were up by 6.5% y-o-y. US formulations revenues were up 15.6% y-o-y backed by market share gains. OPM at 21.2% expanded slightly by 17 bps y-o-y, adjusted for a provision towards R&D, the OPM's stood at 22.2%. Adjusted PAT rose by 20.6% y-o-y to Rs. 770.5 crore, marginally ahead of estimates. Aurobindo's US business, which accounts for half of its sales, is gradually gaining traction driven by a sturdy new product launch pipeline (the company has products already approved & awaiting launch) and easing pricing pressures in the generics space. Further five of its units are still under the USFDA scanner. The management is done with remedial actions and is awaiting a reply from the regulator. As a considerable no of filings awaiting approvals are from facilities that are under the USFDA scanner, successful resolution of USFDA observations would be a key parameter to watch and will be a trigger for an earnings upgrade. Though the European business reported weak performance for the quarter, it is likely to gradually improve. Aurobindo's sales and PAT are expected to grow by CAGR of 9% and 11% respectively over FY2020-FY2022.

Key positives

- US revenue grew strongly by 15.6% y-o-y, led by market share gains.
- Anti-retrovirals (ARV) business grew sturdily by 33% y-o-y due to transition to combination drug TLD.
- Gross margins expand 160 bps y-o-y to 40.6%.

Key negatives

- API segment revenues grew 6.5% y-o-y, underperforming the peers, on the back of adverse mix.
- USFDA clearance for five plants (unit I, IX, XI, VII and New Jersey) is yet to be received.

Our Call

Valuation - Maintain Hold; recent run up in stock price leaves limited upside: Aurobindo derives around half of its revenues from the highly regulated market of the US, while Europe accounts for almost a quarter of the revenues. US revenues for the quarter grew strongly and management expects the momentum to sustain backed by a strong new launch pipeline (Aurobindo has products already approved) and stabilising price erosion. Aurobindo's five plants are still under the USFDA scrutiny. The company has submitted responses and is awaiting a revert from the regulator. The Europe business is also expected to improve gradually and gain traction. Aurobindo reported a mixed performance for Q1FY2021 with a healthy growth in US business, leading to better sales mix and a reduction in net debt levels. Basis this we have revised upwards our earnings estimates for FY2021-FY2022 and have also introduced FY2023 estimates in this note. Sales and PAT are expected to grow by a 9% and 11% CAGR over FY2020-FY2022. At CMP, the stock trades at a valuation of 15.7x / 14.5x its FY2021 / FY2022E earnings. Since the past three months, stock price has run-up substantially by ~49% and thus leaving a limited upside. Further, new approvals are key drivers for sustained growth, as the base business in the US is fairly large. Hence, timely and proper resolution of the USFDA issues is critical. Thus, we maintain our Hold rating on the stock with a revised PT of Rs. 975.

Key Risks

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

Valuation (Consolidated)

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Total Income	19563.6	23098.0	25050.9	27328.5	30100.8
OPM (%)	20.2	21.1	21.8	22.2	22.6
Adj. PAT	2513	2913	3289	3571	4038
EPS (Rs)	42.9	49.7	56.1	61.0	68.9
PER (x)	20.5	17.7	15.7	14.5	12.8
EV/Ebitda (x)	14.7	11.1	9.6	8.1	6.6
P/BV (x)	3.7	3.1	2.6	2.2	1.9
ROCE (%)	16.8	17.7	19.5	19.5	19.7
RONW (%)	19.7	19.0	17.9	16.6	16.0

Source: Company; Sharekhan estimates

Mixed quarter: Aurobindo reported mixed performance for Q1FY2021. Sales grew by 8.8% y-o-y to Rs. 5,925 crore in line with estimates. Revenues grew, led by a 9% growth in the formulations segment, while API sales rose by 6.5% y-o-y, lower than growth reported by peers. US formulations revenues were up 15.6% y-o-y (most of the peers in the industry have reported a decline). Strong growth in the US markets is backed by market share gains. The Europe revenues declined. ARV segment sales were up by 33.6% y-o-y. With US sales growing by string double digits, the mix has improved. Operating profits for the quarter stood at Rs 1,257 crore is up 9.7% y-o-y and broadly in line with estimates. Operating margins at 21.2% expanded slightly by 17 bps y-o-y. Gross margins expanded by 160 bps y-o-y, but higher staff cost and other expenses largely offset the benefits of gross margin expansion. During the quarter the company has done a provision of Rs 60 crore towards development of certain assets by third party. Adjusting for this the operating margins stood at 22.2%. The interest cost declined by 57.8% y-o-y to Rs. 21 crore, while other income rose sharply to Rs 93.3 crore as compared to Rs. 11 crore in Q1FY20. Aurobindo reported a forex gain of Rs 22 crore for the quarter as compared to a gain of Rs 4.7 crore for Q1FY21. Consequently, the adjusted PAT stood at Rs 770.5 crore, up strongly by 20.6% y-o-y and is marginally ahead of estimates.

US Business improving; USFDA approvals awaited: Aurobindo's US business constitutes almost half of consolidated sales. US sales have grown impressively by 15.6% y-o-y. This is a positive development as most of the peers in the industry have reported a weak performance in the US geography. The strong growth can be attributable to market share gains by the company in its key segments. Going ahead, the management expects the growth momentum to sustain in the US business. The company has a sturdy pipeline of 50 products which it plans to launch in FY2021 (it had already launched 6 new products in the US markets in Q1FY21 including an injectible). Also the pricing environment in the US generic space seems to be stabilizing. Aurobindo sees price erosion reducing and prices are likely to be stable. Therefore a strong product pipeline for FY2021 coupled with reducing pricing pressures augurs well from a growth perspective. Aurobindo's US revenues are expected to grow in double digits for FY2021 and FY2022. Further, on the regulatory front, Aurobindo has witnessed partial easing of regulatory pressures from the USFDA. The regulator has cleared the unit-4 of the company, which is a sterile manufacturing facility. This has partially eased off regulatory pressures as unit-4 has around 47 ANDAs filed. However five of the company's plants are still under the USFDA's scrutiny. Four units – units 1, 9, 7 and 11, which were inspected by the USFDA, continue to be under OAI / WL status. Unit 7 manufactures oral solids and accounts of ~20% of US sales, which is substantial. Aurobindo has completed the remedial actions required at all the plants and has submitted a response to the regulator. It has also requested for a desktop audit. A reply from the regulator is awaited and is a key monitorable. Clearance of plants by the USFDA is critical from a growth perspective, as substantial chunk of filings are from units which are under regulatory scanners.

Q1FY2021 Conference call highlights

- ◆ US revenues, at Rs.3107 crore, were up 15.6% y-o-y and accounted for 52.4% of consolidated revenues. Constant currency growth stood at 6.5%.
- ◆ The company got approval for 10 ANDAs, filed for 14 ANDAs, including 3 injectables with the USFDA and has launched six products (including 1 injectible). As on June 30, 2020, the company cumulatively filed 604 ANDAs with the USFDA and received 438 approvals including 28 tentative approvals.
- ◆ Aurobindo has a strong pipeline in injectables segment in the US. Around 80-90 products are under different stages of development. This would drive the growth of the US business over the long term.
- ◆ In FY2021, Aurobindo plans to launch 50 new products and off this it already has approvals from the regulator for substantial portion of the products.
- ◆ EU formulations business revenues declined by 5% y-o-y to Rs.1,322 crore. The segment constituted 22.5% of consolidated sales. A fall in revenue can be attributable to stocking ahead of the pandemic in the region.
- ◆ Anti-retroviral (ARV) revenues, at Rs.425.5 crore, grew by 33.6% y-o-y and accounted for 7.2% of revenues. The sturdy growth can be attributed to transition to TLD from TLE.
- ◆ Revenues from the growth-markets stood at Rs.289.6 crore and have declined 7.5% y-o-y. High inventory built up in Q4FY2020 in some of the key growth markets led to the drop in sales.

- ◆ API segment revenues at Rs.780 crore were up by 6.5%, which is way below growth reported by other industry players. The non betalactum segment revenues declined 7% y-o-y, while the betalactum segment sales were up 16% y-o-y. Aurobindo makes APIs used in antibiotics, which had a very low demand and hence the revenue growth was lower than the industry. The company filed for 3 drug master filings (DMFs) during the quarter.
- ◆ Aurobindo has reduced its net debt by \$168 million q-o-q to \$191 million. The company has also been able to successfully manage working capital cycles and has reduced its debtor days to 49 days as of June 2020 from 60 days earlier.
- ◆ R&D cost stood at Rs. 254 crore, translating in to 4.3% of sales. Going ahead, the management expects the momentum to sustain.

Results

Particulars	Q1FY2021	Q1FY2020	y-o-y %	Q4FY2020	Rs cr
					q-o-q%
Total Income	5924.8	5444.6	8.8	6158.4	-3.8%
Operating profit	1257.4	1146.4	9.7	1342.4	-6.3%
Other income	93.4	11.0	748.8	32.6	186.5%
EBIDTA	1350.7	1157.4	16.7	1375.0	-1.8%
Interest	21.1	49.9	-57.8	31.8	-33.8%
Depreciation	255.5	240.9	6.1	232.4	9.9%
PBT	1074.1	866.7	23.9	1110.8	-3.3%
Tax	303.7	227.8	33.3	228.5	32.9%
Adjusted PAT	770.5	638.9	20.6	882.2	-12.7%
Margins			bps		bps
OPM (%)	21.2	21.1	17	21.8	-58

Source: Company; Sharekhan Research

Revenue mix

Particulars	Q1FY2021	Q1FY2020	y-o-y %	Q4FY2020	Rs cr
					q-o-q%
USA	3107.1	2688.4	15.6	2990.3	3.9
Europe	1322.2	1391.6	-5.0	1652.5	-20.0
Growth Markets	289.6	313.4	-7.6	376.6	-23.1
ARV	425.5	318.5	33.6	381.8	11.4
Formulations	5144.4	4711.9	9.179	5401.2	-4.754
Betalactams	500.3	431.0	16.1	539.2	-7.2
Non Betalactams	279.8	301.2	-7.1	216.4	29.3
API	780.1	732.2	6.542	755.6	3.242
Gross Sales	5924.5	5444.1	8.8	6156.8	-3.8
Dossier Income	0.3	0.4	-25.0	1.7	-82.4
Net Sales	5924.8	5444.5	8.822	6158.5	-3.795

Source: Company; Sharekhan Research

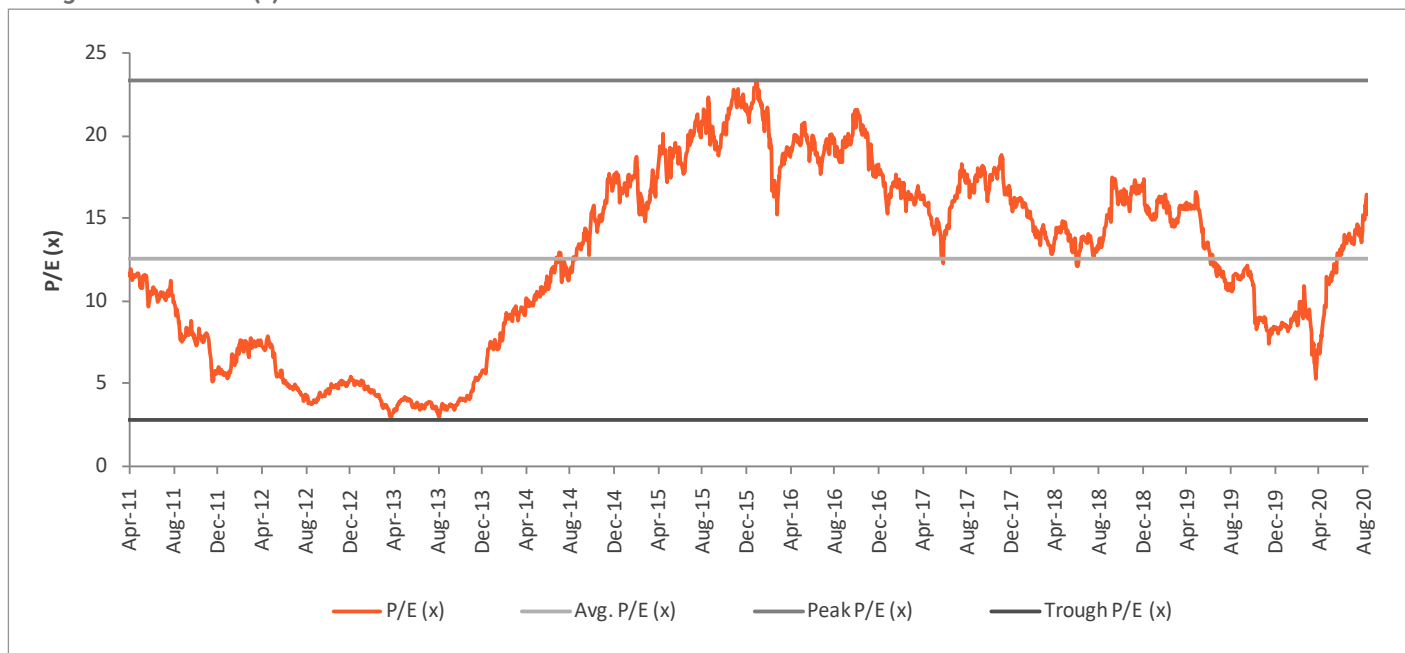
Outlook

US business gradually improving: Aurobindo is a leading Indian pharmaceutical company with presence in the formulations as well as in API space. The company is a leading player in the generics space. Aurobindo derives around 75% of the revenues from the developed markets of the US and Europe. Of late, regulatory pressures seem to be easing a bit with USFDA clearing the Unit-4, which had a sizeable chunk of products linked to it. Also, the company has been able to gain market share in the US, with the revenues clocking a strong double-digit growth for the quarter. Going ahead, the management expects the traction in the US business to continue backed by a strong product launch pipeline and relatively easing of pricing pressures in the US generic markets. However, the company is yet to get USFDA clearance for five of its plants and so new product approvals from plants are held up. A successful resolution of USFDA observations would be a key monitorable and trigger for earnings upgrade. Over the long term, Aurobindo is looking to build a presence in the biosimilar space which is likely to support growth.

Valuation

Maintain Hold; recent run up in stock price leaves limited upside: Aurobindo derives around half of its revenues from the highly regulated market of the US, while Europe accounts for almost a quarter of the revenues. US revenues for the quarter grew strongly and management expects the momentum to sustain backed by a strong new launch pipeline (Aurobindo has products already approved) and stabilising price erosion. Aurobindo's five plants are still under the USFDA scrutiny. The company has submitted responses and is awaiting a revert from the regulator. The Europe business is also expected to improve gradually and gain traction. Aurobindo reported a mixed performance for Q1FY2021 with a healthy growth in US business, leading to better sales mix and a reduction in net debt levels. Basis this we have revised upwards our earnings estimates for FY2021-FY2022 and have also introduced FY2023 estimates in this note. Sales and PAT are expected to grow by a 9% and 11% CAGR over FY2020-FY2022. At CMP, the stock trades at a valuation of 15.7x / 14.5x its FY2021 / FY2022E earnings. Since the past three months, stock price has run-up substantially by ~49% and thus leaving a limited upside. Further, new approvals are key drivers for sustained growth, as the base business in the US is fairly large. Hence, timely and proper resolution of the USFDA issues is critical. Thus, we maintain our Hold rating on the stock with a revised PT of Rs. 975.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E			EV / EBITDA			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Aurobindo Pharma	881.0	58.6	51,639.0	17.7	15.7	14.5	11.1	9.6	8.1	19.0	17.9	16.6
Sun Pharma	521.0	239.9	124,954.0	31.1	24.1	20.0	18.2	15.0	12.9	8.9	11.2	12.0
Lupin	930	45.3	42,160.0	119.5	33.1	25.4	20.2	14.2	11.1	2.8	9.2	10.7

Source: Company, Sharekhan estimates

About company

Hyderabad-based Aurobindo was incorporated in 1986 and manufactures generic formulations and active pharmaceutical ingredients (APIs). Aurobindo generates 90% of its sales from international markets. The company 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 12 months ending June 2018. The company also holds a strong position in many European countries, including France and Italy, where it ranks among the largest generic companies. Aurobindo 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 USFDA, U.K. 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 the 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, the company is one of the few companies able to mitigate this risk due to continuous product launches and approvals. The company is currently grappling through a USFDA scrutiny at its various plants. Continued regulatory concerns are likely to adversely impact performance going ahead, as more than 50% of the company's fillings are from plants that are under USFDA scrutiny.

Key Risks

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

Additional Data

Key management personnel

K Nithyananda Reddy	Vice - Chairman, Whole-time Director, One of the promoters.
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	HDFC Asset Management Co Ltd	8.1
2	Axis Clinicals Ltd	3.0
3	Vanguard Group Inc/The	1.6
4	BlackRock Inc	1.5
5	Reliance Capital Trustee Co Ltd	1.3
6	Amansa Holdings Pvt Ltd	1.1
7	Dimensional Fund Advisors LP	1.1
8	ICICI Prudential Life Insurance Co	0.6
9	Aditya Birla Sun Life Asset Manage	0.5
10	Causeway Capital Management LLC	0.4

Source: Bloomberg

Data as on 4 June 2020

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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