Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Aurobindo Pharma Limited

Growth levers intact

Pharmaceuticals	Sharekhan code: AUROPHARMA	Result Update

Stock Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 935**	
Price Target: **Rs. 1,100**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

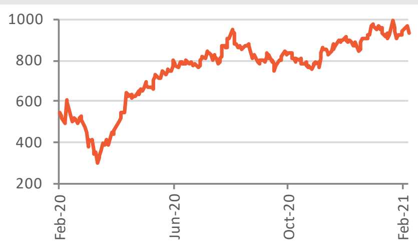
Company details

Market cap:	Rs. 54,791 cr
52-week high/low:	Rs. 1,023 / 281
NSE volume: (No of shares)	66.8 lakh
BSE code:	524804
NSE code:	AUROPHARMA
Free float: (No of shares)	28.2 cr

Shareholding (%)

Promoters	51.9
FII	22.8
DII	12.6
Others	12.73

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.1	15.3	-1.0	70.6
Relative to Sensex	-7.7	-2.9	-35.2	45.6

Sharekhan Research, Bloomberg

Summary

- We retain our Buy recommendation on Aurobindo Pharma Limited (Aurobindo) with a revised PT of Rs. 1,100.
- Q3FY2021 revenues, operating profits and PAT slightly lagged estimates; adjusting for one-off gains, PAT stood at Rs. 836 crore, up 18.5% y-o-y but missed estimates.
- Expected traction in injectable, strong growth outlook for US and Europe geographies would be the key growth drivers, while the areas of Vaccine and API would fuel the growth over the long term.
- Focus on building and developing a strong portfolio of specialty products (biosimilars, oncology, inhalers, transdermal patches, etc) would be key growth drivers.

Aurobindo Pharma Limited's (Aurobindo's) Q3FY2021 revenues, operating profits and PAT were a tad below the estimates. Sales at Rs. 6,365 crore is up 8% y-o-y (slightly below estimates), attributable to an 11.3% y-o-y growth in the formulations segment, while API sales were down 13.6% y-o-y. OPM expanded by 100 BPS y-o-y to 21.5% (estimated OPM 22%) led by a 310 bps expansion in gross margins, which were partly offset by an increase in other expenses. Operating profits for the quarter at Rs. 1,368 crore is up by 13.3% y-o-y. Adjusting for one-off gains, PAT stood at Rs. 836 crore, up 18.5% y-o-y but missed estimates. Aurobindo's injectables business is fast gaining traction with increasing number of regulatory approvals and geographic expansion. The company is also in the midst of commissioning an injectables facility in the US and is also setting up a dedicated facility at Vizag for Europe and RoW markets. Based on this, the annual run-rate of the injectables business is expected to reach $650-700 million over the next three years versus $380 million now. The US formulations business is also on a strong growth footing, backed by a sturdy product pipeline (~50 products to be launched in the US each in FY21 and FY22) and growth in base business. The European business also revived, staging a double-digit revenue growth. Driven by the transition in favor of TLD, the anti-retro-viral (ARV) segment's revenues are expected to grow strongly. Further, Aurobindo is investing ~ Rs. 1,500 crore (~$200-220 million) annually towards capacity expansion over FY21 and FY22, which offers ample growth visibility. In the long term, vaccines and APIs are expected to be the growth drivers. Aurobindo is looking to double its API sales over the next 4 years, largely driven by the capex under the PLI scheme, though it is at planning stage. It would be developing PCV (Pneumococcal Conjugate Vaccine) and has also entered into agreement with a US company to manufacture viral vaccines. Also it is doubling its vaccine capacity to 440 million doses from 220 million doses by June 2021. Successful clearance from USFDA for five plants is awaited as the company has submitted its responses. In the long term, focus on building and developing a strong portfolio of specialty products (biosimilars, oncology, inhalers, transdermal patches, etc) would be key growth drivers.

Key positives

- European sales grew 13.2% y-o-y, better than estimates.
- ARV business grew sturdily by 41.5% y-o-y due to transition to combination drug TLD
- OPM expanded by 100 bps y-o-y to 21.5% backed by a 310 bps expansion in gross margins
- Aurobindo turned cash positive with net cash of Rs. 117 crore as of December 2020.

Key negatives

- API segment revenues declined by 13.6% y-o-y due to a 24.3% decline in Betalactum sales.
- USFDA clearance for five plants (unit I, IX, XI, VII and US) is yet to be received.

Our Call

Valuation - Maintain Buy with a revised PT of Rs. 1,100: Aurobindo expect a strong growth outlook for the US business. A sturdy pipeline of product launches lined up over FY21 and FY22, better traction in lucrative injectables and expected momentum in recently launched products would drive US sales. The European business is also on path to improvement with revenue clocking a double-digit growth for the quarter. The global injectables business, which has an annual run rate of $380 million, is expected to reach $650-700 million over the next three years backed by increasing approvals, geographic expansions and improving demand traction. Over the long term, vaccines and APIs are expected to be the growth drivers. Aurobindo expects the API revenues to double over the next four years, with a large chunk of growth being driven by PLI-scheme led investments. Further, to support the growth going ahead, Aurobindo has plans to invest ~$200-220 million annually towards capacity expansion each in FY2021 & FY2022. This provides ample growth visibility. Aurobindo's five plants are under the USFDA's scrutiny and it is waiting for a resolution from the regulator. At CMP, the stock trades at a valuation of 14.4x/12x its FY2022/FY2023E EPS, which is lower than its peers. Improving growth prospects, better earnings visibility and a strengthening balance sheet would be the key positives. We retain our Buy recommendation on the stock with a revised PT of Rs. 1,100.

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.

Valuations (Consolidated) Rs cr

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Total Income	19563.6	23098.0	25032.9	28490.7	32354.5
Operating profits	3952.0	4863.8	5457.2	6324.9	7409.2
OPM (%)	20.2	21.1	21.8	22.2	22.9
Adj. PAT	2513	2913	3269	3796	4550
EPS (Rs.)	42.9	49.7	55.8	64.8	77.7
PER (x)	21.8	18.8	16.8	14.4	12.0
EV/Ebidta (x)	15.5	11.8	9.5	7.7	6.0
P/BV (x)	3.9	3.3	2.3	2.0	1.7
ROCE (%)	16.8	17.7	18.1	18.5	20.4
RONW (%)	19.7	19.0	16.3	15.1	15.6

Source: Company; Sharekhan estimates

Q3FY2021 performance tad below estimates: Q3FY2021 performance slightly lagged estimates on the topline, operating profit and PAT fronts. Adjusted PAT at Rs. 836.3 crore and marginally missed estimates of Rs. 875 crore. Sales rose by 8% y-o-y to Rs. 6,365 crore, a tad below estimates. Revenue growth was attributable to a 11.3% growth in the formulations segment, while API sales were down 13.6% y-o-y. US formulations sales at Rs. 3171.6 crore, grew 6.8% y-o-y, marginally slower than the expected growth of 11% while the Europe sales at Rs. 1671 crore were up 13.2% y-o-y. ARV segment sales rose strongly by 41.5% y-o-y to Rs. 443 crore. Operating profits at Rs. 1,368 crore is up by 13.3% y-o-y as compared to estimates of Rs. 1423 crore. Operating margins at 21.5% expanded by 101 bps y-o-y as against estimated 22%. Gross margins expanded by 310 bps y-o-y. However, higher other expenses partly offset the gains in the gross margins. During the quarter the company reported a one-time extraordinary income of Rs. 2831 crore which includes Rs. 3093 crore towards gain on sales of business of assets of Natrol, Rs. 152.39 crore gain on account of re-measurement of equity interest in Eugia Pharma Specialties Limited and Rs. 431 impairment charge on account of COVID-19 led challenges in certain markets and its impact on product related intangibles and Goodwill. Also the tax on the exceptional income stood at Rs. 704 crore. Consequently, the adjusted PAT stood at Rs. 836 crore, up strongly by 18.5% y-o-y, and is marginally below estimates.

Strong outlook for US business: The US business constitutes around half of the Aurobindo's overall consolidated sales. US sales though grew at a slower than anticipated pace of 7% y-o-y, but outlook for the US business remained strong. Multiple factors, which include product launches as well as growth in the base business could be key growth drivers. In Q3FY2021, the company has launched 11 new products in the US including four injectables. Further, it has a sturdy pipeline of 50 products, which it plans to launch in FY2021 (it had already launched around 34 new products 9MFY21 including injectables) and also expects the new launch momentum to sustain going ahead in FY2022, which would be one of the key growth drivers.

Injectables gaining traction, Aurobindo well-poised to harness opportunity: Aurobindo has set its eyes on the high-focus injectables business and sees it as one of the key growth levers. Aurobindo has already launched 4 injectable products in the US in Q3 and has planned 4 launches in Q4FY21 as well. Annually, the company expects around 12-15 product launches in this space globally and expects the momentum to sustain in FY2022 as well. The company has built a strong presence in injectables across delivery systems such as liquid & lyophilized vials, bag, ampoules and pre filled syringes and has a strong manufacturing and execution capabilities as well. The company has five manufacturing facilities which are cleared by various regulators for the making the injectable. In addition to this, the company is in the midst of commissioning a facility in the US aimed at catering to the requirements of the US market and is also setting up a dedicated manufacturing facility for Europe and RoW markets in Visakhapatnam. The Europe accounts for around 20% of the global injectables markets and is well-poised to grow going ahead. Overall Aurobindo expects the annual run rate for the injectable products to touch ~$650-700 million over the next three years from the current run rate of ~$380 million.

Q3FY2021 Conference call highlights

- US revenues, at Rs. 3,171 crore, were up 7% y-o-y and accounted for 49.8% of consolidated revenues. Constant currency growth stood at 6.6%. During Q3FY2021, the company divested the Natrol business. Aurobindo filed for 8 ANDAs with the USFDA in Q3FY2021. While the company received final approval for 13 ANDAs including 9 injectables. Aurobindo has launched 11 new products in the US markets including 4 injectable.
- As on December 2020, the company cumulatively filed 634 ANDAs with the USFDA and received 434 approvals including 29 tentative approvals, while 171 ANDAs are under review.
- EU formulations business revenues grew by 13.2% y-o-y to Rs. 1671 crore and constitutes around 26.3% of overall sales. Aurobindo sees Europe being impacted by a second wave of the COVID-19 Pandemic, but expects the situation to improve on the back of vaccination drive which has commenced across major markets of the globe.
- Anti-retroviral (ARV) revenues, for Aurobindo reported a remarkable 41.5% y-o-y growth to Rs. 443 crore and constituted around 7% of overall revenues. Strong growth can be attributable to the conversion of TLE to TLD, which could sustain going ahead at least in the near to medium term.
- Revenues from the growth markets stood at Rs. 396 crore, up by 14.6% y-o-y and accounted for around 6.2% of the overall quarterly revenues.

- API segment sales stood at Rs. 682.5 crore and declined by 13.6% y-o-y driven by a 24% y-o-y decline in the Betalactum sales. Going ahead the company sees the API segment to be one of the key growth drivers and expects the sales to almost double over the next four years. A chunk of this growth is expected to be coming in from the investments in capacity expansion under the PLI scheme as the company has been awarded three products under the scheme, though it is still evaluating the case and may go in for 2-3 products. Moreover, it looks to invest around Rs. 3000 crore spread over the next 32 months across.
- Aurobindo is enhancing its focus on vaccines area and has entered a joint venture to develop a PCV (Pneumococcal Conjugate Vaccine) vaccine, which has a global market size of around $6bn. It the currently in the trials stage with the Phase III trials expected to commence in March 2020. Also it has forayed in to the Viral vaccines through an acquisition in Feb 2020 (done through a step down subsidiary). Also Subsidiary company Auro Vaccines is developing 4 viral vaccines including one for Covid.
- R&D cost for the quarter stood at Rs. 390 crore and was ~6.1% of the sales. Going ahead, the management expects the momentum to sustain.
- Aurobindo's has turned net cash positive for as of the quarter as has a net cash balance of RS 117 crore. This is in line with the company's strategy of repaying its debt by FY2022.
- Aurobindo plans to incur a capex of $200-220 million (~Rs. 1,500 crore) annually over FY2021 and FY2022. This capex would be in addition to the investments required for setting up plants under the PLI scheme.
- Aurobindo's plants 1,9,7 and 11 are under the USFDA with an OAI/WL status. The company has completed the remediation process and is awaiting a reply from the USFDA for the re-inspection.

Results Rs cr

Particulars	Q3FY2021	Q3FY2020	Y-o-Y %	Q2FY2021	Q-o-Q %
Total Income	6364.9	5895.0	8.0	6483.4	-1.8%
Operating expenditure	4996.3	4687.0	6.6	5050.6	-1.1%
Operating profit	1368.6	1208.0	13.3	1432.8	-4.5%
Other income	72.8	22.0	231.2	47.2	54.4%
EBIDTA	1441.4	1230.0	17.2	1480.0	-2.6%
Interest	19.5	37.1	-47.5	15.7	24.1%
Depreciation	276.5	250.1	10.6	257.3	7.5%
PBT	1145.4	942.8	21.5	1206.9	-5.1%
Tax	355.1	232.9	52.5	387.3	-8.3%
Adjusted PAT	836.3	705.8	18.5	805.1	3.9%
Reported PAT	3650.1	705.8	417.1	805.1	353.4%
Margins			**bps**		**bps**
OPM (%)	21.5	20.5	101	22.1	-60

Source: Company; Sharekhan Research

Revenue mix

Particulars	Q3FY2021	Q3FY2020	Y-o-Y %	Q2FY2021	Q-o-Q %
USA	3171.6	2969.4	6.8	3189.8	-0.6
Europe	1671.2	1476.3	13.2	1514.8	10.3
Growth Markets	396.2	345.9	14.5	446.5	-11.3
ARV	443.3	313.4	41.4	502.7	-11.8
Formulations	**5682.3**	**5105**	**11.31**	**5653.8**	**0.504**
Betalactums	386.8	511.1	-24.3	434.3	-10.9
Non Betalactums	295.6	278.7	6.1	394.6	-25.1
API	**682.4**	**789.8**	**-13.6**	**828.9**	**-17.67**
Gross Sales	**6364.7**	**5894.8**	**8.0**	**6482.7**	**-1.8**
Dossier Income	0.0	0.3	-100.0	0.6	-100.0
Net Sales	**6364.7**	**5895.1**	**7.966**	**6483.3**	**-1.829**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view: Improved growth prospects

Indian pharmaceutical companies are better-placed to harness opportunities and clock healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in the US generics market), rise in product approvals and plant resolutions by the USFDA coupled with strong growth prospects in domestic markets and emerging opportunities in the API space would be the key growth drivers. This would be complemented by the strong capabilities developed by Indian companies (leading to a shift towards complex molecules, biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharma companies.

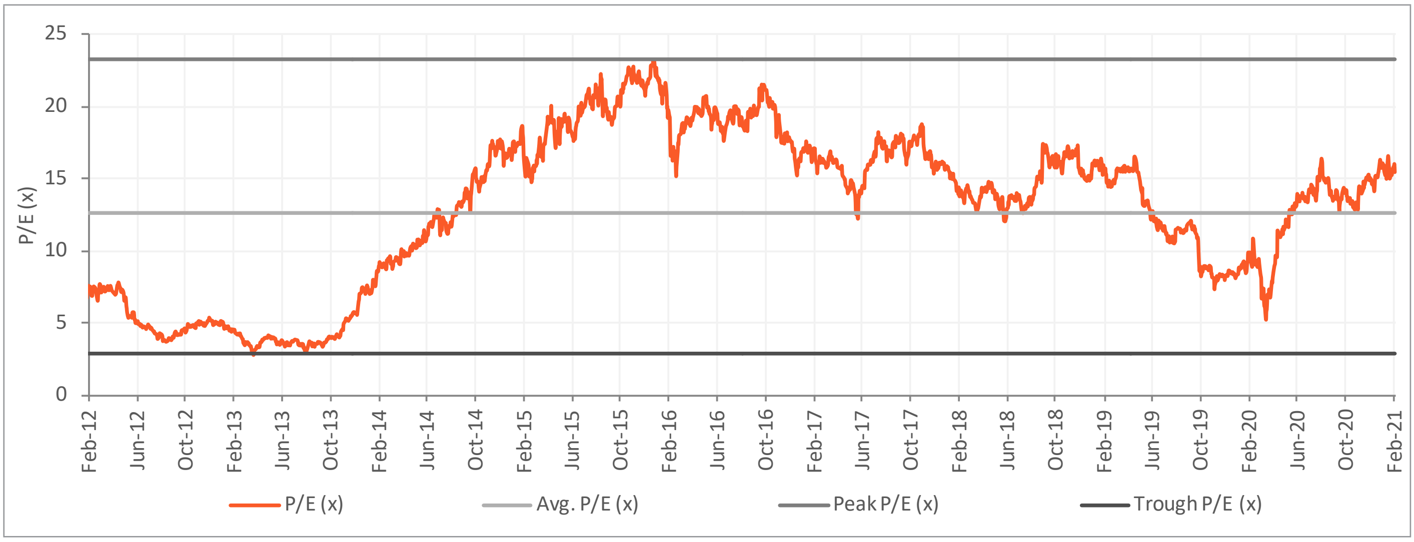
■ Company outlook - US business gradually improving

Strong growth outlook exists for the US business driven by a improving traction from the generic injectables space (with comparatively low competition), a sturdy product pipeline and expected traction the recently-launched products. The European business too is on the path to recover with demand normalizing and showing signs of improvement. However, Aurobindo is awaiting USFDA clearance for five of its plants. For 4 of 5 plants under USFDA's scanner, the company has completed the remediation and has submitted its responses. 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 specialty segment which includes areas of biosimilars, oncology inhalers, transdermal patches amongst others which is likely to support growth. The recent approval under PLI scheme could also result in a strong growth in the API segment though the company is evaluating its plans to take up 2-3 products, for which it has been granted the approval.

■ Valuation - Maintain Buy with a revised PT of Rs. 1,100

Aurobindo expects strong growth outlook for the US business. A sturdy pipeline of product launches lined up over FY21 and FY22, better traction in lucrative injectables and expected momentum in recently launched products would drive US sales. The European business is also on path to improvement with revenue clocking a double-digit growth for the quarter. Growth momentum is expected to sustain going ahead. The global injectables business, which has an annual run rate of $380 million, is expected to reach $650-700 million over the next three years backed by increasing approvals, geographic expansions and improving demand traction. Over the long term, vaccines and APIs are expected to play out well and would be growth drivers. Aurobindo expects the API revenues to double over the next four years, with a large chunk of growth being driven by PLI-scheme led investments. Further, to support the growth going ahead, Aurobindo has plans to invest ~$200-220 million annually towards capacity expansion each in FY2021 & FY2022. This provides ample growth visibility. Aurobindo's five plants are under the USFDA's scrutiny and it is waiting for a resolution from the regulator. At CMP, the stock trades at a valuation of 14.4x/12x its FY2022/FY2023E EPS, which is lower than its peers. Improving growth prospects, better earnings visibility and a strengthening balance sheet would be the key positives. We retain our Buy recommendation on the stock with a revised PT of Rs. 1,100.

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 (x)			EV/EBIDTA (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
AurobindoPharma	935.0	58.6	54,791.0	18.8	16.8	14.4	11.8	9.5	7.7	19.0	16.3	15.1
Sun Pharma	644.0	239.9	154,393.0	38.4	26.8	23.3	22.4	17.3	15.3	8.9	12.3	12.5

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. Over the long term, Aurobindo is looking to build a presence in the specialty segment which includes areas of biosimilars, oncology inhalers, transdermal patches amongst others which is likely to support growth. The recent approval under PLI scheme could also result in a strong growth in the API segment though the company is evaluating its plans to take up 2-3 products, for which it has been granted the approval.

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, promoter.
N Govindarajan	Managing Director
P.V. Ramaprasad Reddy	Non-executive Director, Promoter
Santhanam Subramanian	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co Ltd	5.67
2	Axis Clinicals Ltd	3.0
3	Vanguard Group Inc/The	1.59
4	BlackRock Inc	1.34
5	Dimensional Fund Advisors LP	1.13
6	SBI Funds Management Pvt Ltd	0.94
7	ICICI Prudential Life Insurance Co	0.69
8	Norges Bank	0.49
9	IDFC Mutual Fund/India	0.44
10	Invesco Ltd	0.4

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

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