



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. 872	
Price Target: Rs. 1024	↔

↑ Upgrade
↔ Maintain
↓ Downgrade

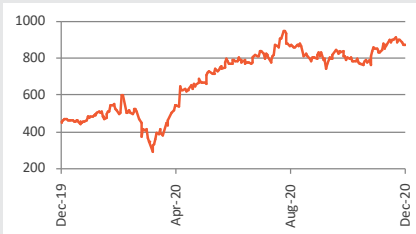
Company details

Market cap:	Rs. 51,083 cr
52-week high/low:	Rs. 967 / 281
NSE volume: (No of shares)	66.8 lakh
BSE code:	524804
NSE 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	1.9	7.5	10.5	94.4
Relative to Sensex	-4.7	-12.8	-29.5	81.0

Sharekhan Research, Bloomberg

Summary

- We retain our Buy recommendation on Aurobindo Pharma Limited (Aurobindo) with an unchanged PT of Rs. 1,024.
- Aurobindo's US business to stage a marked improvement led by sturdy pipeline of new products, expected traction in the lucrative injectables space and growth in the recently launched products.
- Further, Aurobindo is investing ~\$180 -200 million (~Rs. 1,350-1,500 crore each) towards capacity expansion in FY2021 and FY2022 and encompassing areas of injectables and oral solids across geographies.
- Aurobindo's sales and PAT are expected to clock a CAGR of 10% and 14%, respectively, over FY2020-FY2023.

We interacted with the management of Aurobindo Pharma Limited (Aurobindo) to get an update on the recent business developments and outlook. The commentary suggested robust demand environment in the months ahead. Aurobindo's US business is expected to stage a marked improvement. A mix of factors, which includes a sturdy pipeline of new products, expected traction in the lucrative injectables space and growth in the recently launched products would fuel US business' revenues. Aurobindo plans to launch around 50 products in the US in FY2021 (in H1FY2021, it has launched 23 products) and is on track to achieve the same. Further, it plans to sustain the launch momentum going in to FY2022 as well and has plans to launch a similar number (~50) of new products, including injectables, which would be a key growth driver. Aurobindo has filed over 30 ANDAs in FY2021 till date and looks to file another 15-20 ANDAs in remainder of FY2021. A strong pipeline of products awaiting USFDA approvals bodes well from a growth perspective. The European business is also reviving after a weak performance in H1FY2021 as demand outlook improves and stock levels normalise. Driven by the transition in favor of TLD, the anti-retro-virals (ARV) segment's revenues are expected to grow strongly. Further, Aurobindo is investing ~\$180 -200 million (~Rs. 1,350-1,500 crore each) towards capacity expansion in FY2021 and FY2022 and encompassing areas of injectables and oral solids across geographies. This provides ample visibility on growth. Successful clearance from USFDA for its plants is awaited as the company has submitted its responses. Over the long term, a focus on building and developing a strong portfolio of specialty products (biosimilars, oncology, inhalers, transdermal patches, etc) would be key growth drivers. Aurobindo's sales and PAT are expected to clock a CAGR of 10% and 14%, respectively, over FY2020-FY2023.

Our Call

Valuation - Maintain Buy with an unchanged PT of Rs. 1,024: Aurobindo expects strong growth momentum in the US business to sustain going ahead. A sturdy pipeline of new product launches lined up over FY21 and FY22, improving traction in lucrative injectables and expected momentum in recently-launched products would drive US sales. After a weak performance in H1FY2021, European revenues have also bounced back and are likely to improve backed by a healthy demand outlook. On account of a transition from TLE to TLD, the anti-retroviral segment's revenues are likely to grow impressively. Further, to support the growth going ahead, Aurobindo is investing \$180-200 million 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 14.2x/11.8x 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 drivers for growth and would support P/E multiple expansion. We retain our Buy recommendation on the stock with an unchanged PT of Rs. 1,024.

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)

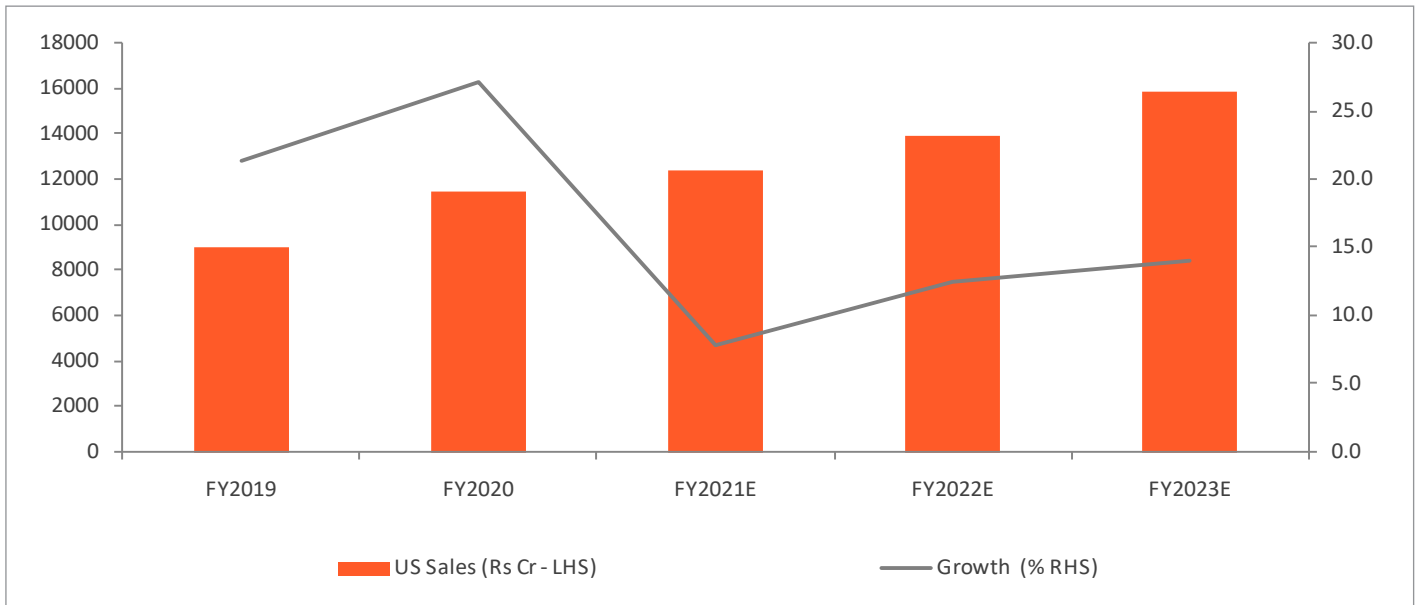
Particulars	FY19	FY20	FY21E	FY22E	FY23E
Total Income	19563.6	23098.0	24122.0	27355.4	31015.9
Operating profits	3952.0	4863.8	5258.6	6072.9	7102.6
OPM (%)	20.2	21.1	21.8	22.2	22.9
Adj. PAT	2513	2913	3141	3609	4321
EPS (Rs)	42.9	49.7	53.6	61.6	73.7
PER (x)	20.3	17.5	16.3	14.2	11.8
EV/Ebitda (x)	14.6	11.0	9.8	8.0	6.3
P/BV (x)	3.7	3.0	2.6	2.2	1.9
ROCE (%)	16.8	17.7	18.7	20.2	22.2
RONW (%)	19.7	19.0	17.2	16.8	17.1

Source: Company; Sharekhan estimates

Key takeaways from management interaction:

US business standing strong backed by sturdy new launches; injectables gaining traction: Aurobindo has a sizeable presence in the US pharma markets. US constitutes 50% of the company’s overall revenue. Aurobindo has managed to sustain its growth momentum in the US for the quarter ending September, primarily led by improved demand. The outlook for US business is strong and Aurobindo is well-placed to harness the opportunities. In the US the company has strong product pipeline which would unfold going ahead and provide the impetus for growth. Aurobindo is on track to achieve its guidance of launching 50 new products in the US in FY2021. As of H1FY2021, it has launched around 23 products and seems confident to launch 27 new products in 2HFY2021. Of the 27 new products lined up for launch, 7-8 products would be in the lucrative injectables space as the company has already received approvals for the same. The remaining launches would be in the orals space. Moreover, the momentum of filling is also sturdy with Aurobindo looking to file around 45 new ANDAs in FY2021 (in H1FY2021 the company has already filed for over 30 ANDAs with the USFDA), which would enable the company to maintain its strong momentum of product launches. Therefore, Aurobindo is looking to maintain the momentum of 50 new launches in FY2022 as well. In addition to the new launches, the base business in the US is also large enough and is likely to support the growth. Further, price erosion in the US markets seems to be stabilizing as of now, however in the post pandemic times as production across geographies commence, the price erosion is likely to crop up and the company expects it to stay in mid single digits, which is unlikely to have any material impact on the growth prospects. Therefore a strong new product pipeline with a sizeable share coming from the lucrative injectables space, likely traction in the recent launches would drive the growth of the US business.

US Business – Sales & Sales Growth Trends



Source: Company; Sharekhan Research

Europe, ARVs to stage healthy growth:

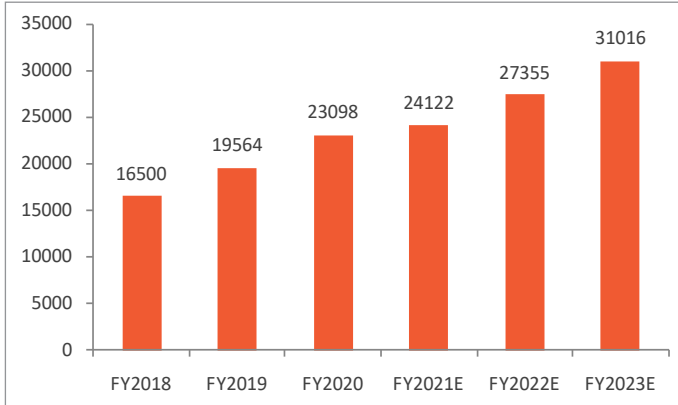
Aurobindo derives ~30% of its revenues from the European regions and RoW countries. Given a strong performance in the Q4FY2020, the Europe sales declined in Q1FY2021 reflecting the partial impact of the lockdown as well. Further in Q2 the performance normalized and the management expects the improvement to sustain going ahead as well. Therefore Aurobindo's Europe performance in H2FY2021 is expected to be better than that of H1FY2021. While the ARV segment's outlook is also robust aided by the transition to the TLD from TLE.

Capex plans: Aurobindo has lined up a healthy capex plan of investing \$180-200 million each for FY2021 and FY2022 towards expanding the injectables as well as oral solids' capacity. Aurobindo is setting up a new injectables plant in the US while it is also setting up a new injectables plant at Vizag aimed to cater to the demand from the EU and emerging markets. In addition to this is also in the process to set up a new plant for transdermals and inhalers in the US, though a large part of the inhalers would continue to be supplied from India. Also the company is doubling its capacity at unit 15 and Unit 10, both of which manufacture oral solids. The capex would be funded by internal accruals, thus unlikely to exert any pressure on the financials. Collectively, sturdy capacity expansion plans spread across the injectables as well as the oral solids bodes well and provides ample visibility on growth prospects.

Corrective actions done; USFDA resolution awaited: Aurobindo's plants 1,7, 9,11 are under USFDA inspection with an OAI/WL status. The company has completed the remediation process and is awaiting a reply from the USFDA. Also, the company is largely done the CAPA's (corrective and preventive action) and is awaiting a re-inspection from the regulators. With respect to the Aurolife facility, the company has engaged a consultant and expects to commence the remediation process soon.

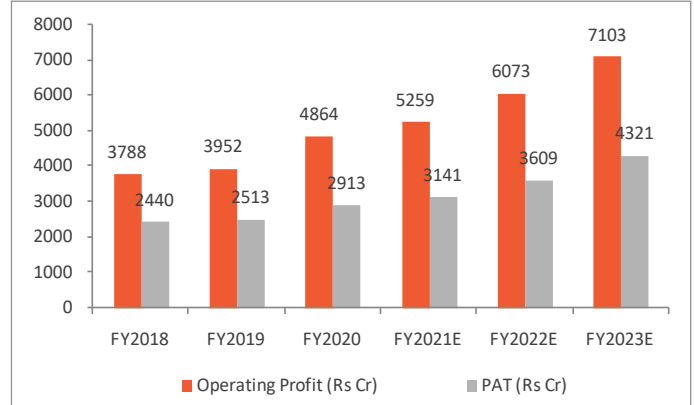
Financials in charts

Sales Trends (RS Cr)



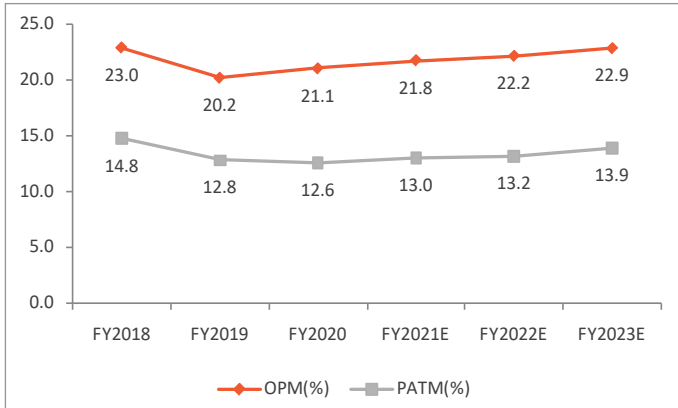
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



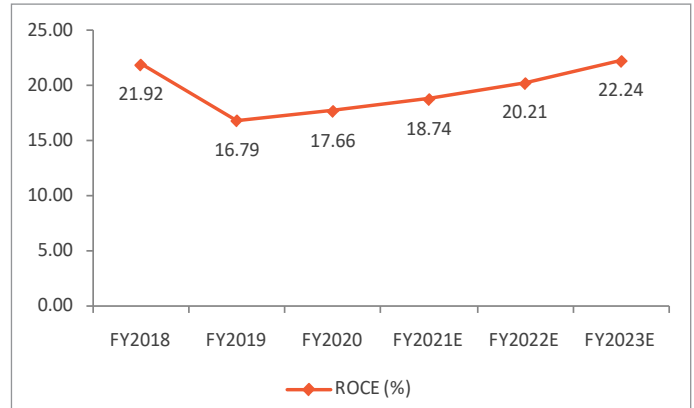
Source: Company, Sharekhan Research

OPM's to improve



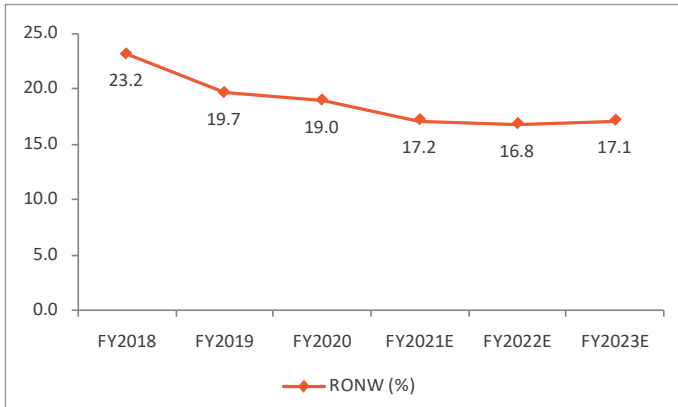
Source: Company, Sharekhan Research

ROCE Trends (%)



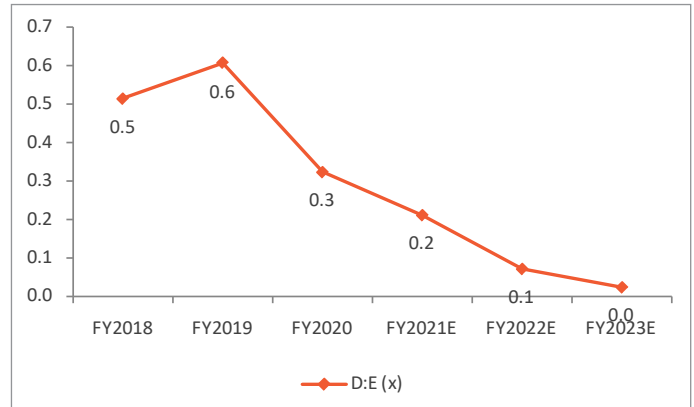
Source: Company, Sharekhan Research

RoE Trends (%)



Source: Company, Sharekhan Research

Debt : Equity (x)



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 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.

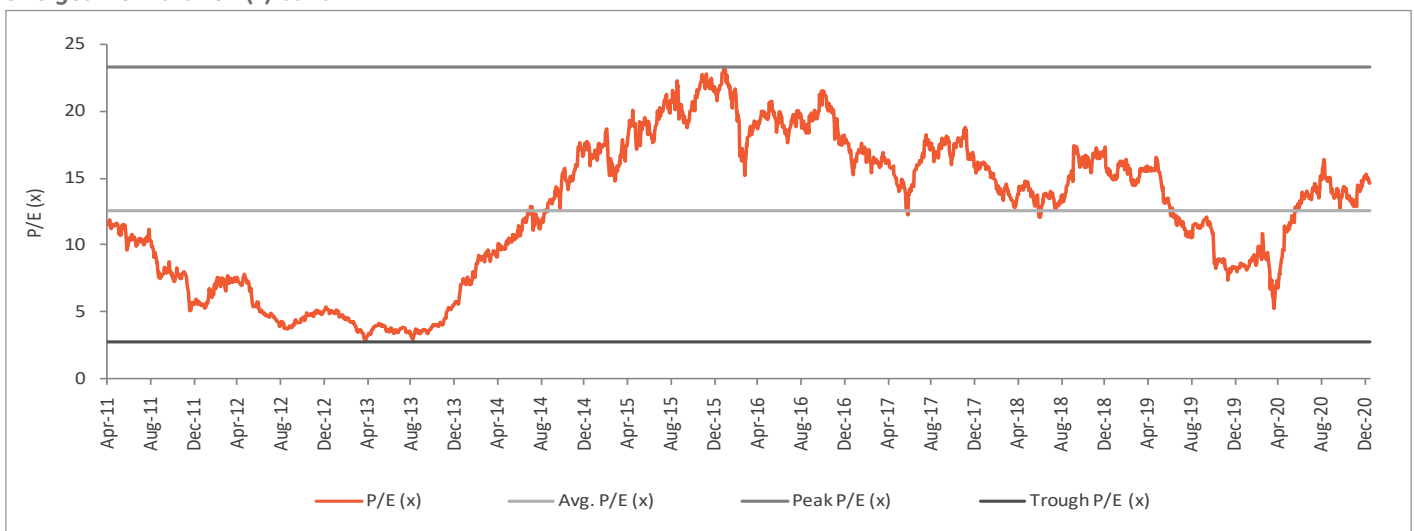
■ Company outlook - Overall business outlook improving

Aurobindo a leading generics player and has a presence in the formulations as well as in API space. Aurobindo derives around 75% of the revenues from developed markets of the US and Europe. Strong growth outlook exists for the US business driven by an improving traction from the lucrative 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. 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 among others, which is likely to support growth.

■ Valuation - Maintain Buy with an unchanged PT of Rs. 1,024

Aurobindo expects strong growth momentum in the US business to sustain going ahead. A sturdy pipeline of new product launches lined up over FY21 and FY22, improving traction in lucrative injectables and expected momentum in recently-launched products would drive US sales. After a weak performance in H1FY2021, European revenues have also bounced back and are likely to improve backed by a healthy demand outlook. On account of a transition from TLE to TLD, the anti-retroviral segment's revenues are likely to grow impressively. Further, to support the growth going ahead, Aurobindo is investing \$180-200 million 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 14.2x/11.8x 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 drivers for growth and would support P/E multiple expansion. We retain our Buy recommendation on the stock with an unchanged PT of Rs. 1,024.

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 / EBITDA		RoE (%)				
				FY21E	FY22E	FY21E	FY22E	FY21E	FY21E	FY22E		
Aurobindo Pharma	872.0	58.6	51,088.0	17.5	16.3	14.2	11.0	9.8	8.0	19.0	17.2	16.8
Sun Pharma	571.0	239.9	137,083.0	34.0	25.1	21.1	19.9	15.7	13.6	8.9	11.7	12.4

Source: Company, Sharekhan Research

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

Source: Company

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

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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 deteriorating 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

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