



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. 761	
Price Target: Rs. 915	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 44,596 cr
52-week high/low:	Rs. 1064 / 747
NSE volume: (No of shares)	31.9 lakh
BSE code:	524804
NSE code:	AUROPHARMA
Free float: (No of shares)	28.2 cr

Shareholding (%)

Promoters	51.8
FII	25.4
DII	12.6
Others	10.19

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-20.4	-25.1	-18.2	-13.6
Relative to Sensex	-25.5	-39.0	-25.7	-58.3

Sharekhan Research, Bloomberg

Summary

- Aurobindo Pharma (Aurobindo) reported a weak performance for Q1FY22 and the results missed estimates.
- Multiple headwinds like higher price erosion and inventory built up across channels have emerged for the US business and the same is expected to sustain at-least in the near term.
- Over the long term, efforts to build presence in specialty segments - biosimilars, oncology & injectables could be the growth drivers, but near term headwinds in US business are expected to slow down the growth
- At CMP, the stock is trading P/E of 12.4x and 10.8x its FY22E and FY23E EPS, which is attractive. we retain our Buy recommendation with revised PT of Rs. 915.

Aurobindo Pharma's (Aurobindo) Q1FY22 results were weak and missed estimates owing to price erosion in the US and inventory build-up. Consolidated revenue fell by 3.8% y-o-y to Rs. 5,702 crore due to 1.5% y-o-y drop in US sales (adjusting for Natrol divestments). Anti-retroviral (ARV) sales dropped by 30.3% y-o-y due to higher stocking for advance procurement in FY2021. OPM was flat at 21.2% y-o-y as lower operating expenses offset a decline in gross margins. Tracking operating performance, PAT fell 1.7% y-o-y to Rs. 770 crore. Headwinds such as competition-led price erosions in the US business (that fetches half of overall sales) and strong inventory build-up across channels hit Q1 numbers and the company expects the impact to sustain at least in the near term. Nevertheless, Aurobindo has a strong product pipeline for the US, which would help it partly offset the effect of price erosion, but lack of clarity exists around liquidation of higher channel stocks. In addition, Europe and other regions are gradually opening up as the pandemic eases and their performance is expected to improve. Other growth levers such as efforts to enhance presence in the complex generics through focus on biosimilars, inhalers, transdermal patches and injectables, bodes well and provides visibility for growth. Aurobindo is also close to kick-starting its vaccine manufacturing capacity that provides it a fresh growth avenue. The company's focus on building a strong portfolio of specialty products would be key long-term growth drivers, albeit pricing pressures and elevated channel stocks act as near term headwinds.

Key positives

- Europe business grew sturdily by 19.7% y-o-y with the revenue share increasing by 4% y-o-y to 28%
- Aurobindo has launched 5 new products including 2 injectables in the US markets.

Key negatives

- US sales declined by 1.5% y-o-y to Rs 2681 cr, impacted by higher price erosion and inventory buildup across channels.
- USFDA inspected unit 1 and issued Form 483 with 7 observations. Resolution of other plants is awaited.

Our Call

Valuation - Maintain Buy with a revised PT of Rs. 915: Aurobindo is witnessing multiple headwinds that have emerged especially for its US business such as higher price erosion and built up of inventories across channels. These headwinds are expected to exert pressures on US revenues at least in the near term. While the company has plans to launch 30+ new products in US in FY2022, which could enable to partly mitigate the impact of the price erosion, but lack of clarity exists around liquidation of higher channel stocks. The other geographies such as Europe have a strong growth outlook. Further Aurobindo is on track to file for its biosimilar products in FY2022. Also the injectables business is growing at a healthy pace and the company has retained its guidance of achieving a \$650-700 mn turnover over the next 3 years. Aurobindo's acquisition of 51% stake in Animal health company Cronus is at a substantially higher valuation. Given the weak performance in Q1FY2022 and emerging headwinds we have revised our estimates downwards for FY22E/FY23E and have also introduced FY24 estimates in this note. At CMP, the stock is trading at a valuation of 12.4x and 10.8x its FY22E and FY23E EPS, which is attractive. A possible de-merger of the injectables business could provide value unlocking opportunities. Hence we retain our Buy recommendation on the stock with a revised PT of Rs. 915.

Key Risks

Delay in the 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	Rs cr				
	FY20	FY21	FY22E	FY23E	FY24E
Total Income	23098.5	24774.6	25879.4	28624.6	31046.6
Operating profits	4864.3	5333.4	5745.2	6469.2	7233.9
OPM (%)	21.1	21.5	22.2	22.6	23.3
Adj. PAT	2914	2474	3596	4121	4667
EPS (Rs)	49.7	42.2	61.4	70.3	79.7
PER (x)	15.3	18.0	12.4	10.8	9.6
EV/Ebitda (x)	9.7	8.1	6.9	5.5	4.3
P/BV (x)	2.7	2.0	1.8	1.5	1.3
ROCE (%)	17.7	18.6	17.9	18.9	19.1
RONW (%)	19.0	12.8	15.2	15.1	14.8

Source: Company; Sharekhan estimates

Weak Quarter; results miss estimates: Aurobindo reported a weak performance for the quarter and the results missed estimates. The performance was impacted due to the price erosion in the US markets and a higher channel inventory. Consolidated revenues at RS 5702 cr declined by 3.8% y-o-y led by a decline in the US sales, down by 1.5% y-o-y adjusting for Natrol divestments. The ARV sales also declined by 30.3% y-o-y attributable to a higher stocking on advance procurement in the last year. Revenues missed estimates. The operating profits at Rs 1209 crore declined by 3.8% y-o-y in line with the drop in the topline and were below estimates. The operating margins at 21.2% were flat on a y-o-y basis as the lower operating expenses compensated for the 90 bps decline in gross margins. Tracking the operating performance, the PAT for the quarter at Rs 770 cr declined by 1.7% y-o-y and missed estimates.

Price erosion and higher channel stocks to drag the US performance: The US markets accounts for around half of the company's overall revenues of the Aurobindo. The US sales for Q1FY2022 have declined by 1.5% y-o-y adjusting for the Natrol divestment done in FY2021. US sales stood at Rs 2681 cr as compared to RS 2722 cr in corresponding quarter. Higher single digit price erosion (the normal price erosion factored in is in mid single digits) on the portfolio in the US and an inventory buildup across channels (in anticipations of a possible disruption due to the pandemic) have impacted the performance in the US. Going ahead, while Aurobindo is expected to maintain its product launch momentum in FY22 with 30+ product launches planned in the US markets, the buildup of inventory across the channels (Sellers and distributors) is expected to moderate the US topline growth, especially for FY2022. Though the management has not guided around the possible time required for liquidation of the inventory, but the fact that 65% of the portfolio is amongst the top ranked in their respective categories, bodes well. Over the long term Aurobindo has a strong product pipeline planned for the US markets including the Injectables. As on June 2021, the company has a total of 654 ANDAs filed with the USFDA which includes 480 approved ones while 29 are with tentative approvals. Further in FY2021, the company had received a total of 42 new approvals including 17 injectables which points a strong launch pipeline as well. Also the complex generics space is fast gaining traction and Aurobindo currently has a small presence in the complex generics space but is looking to enhance its presence gradually in the segment by focusing on areas of biosimilars, inhalers, transdermal patches and injectables. Collectively, a strong overall new product pipeline, focus on injectables business and a gradual improvement in the complex generics would be the key growth drivers for the US business over the longer term, but near term emerging headwinds in the form of higher than expected price erosion and channel inventory build up would slow down the growth in the US topline.

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. For Q1FY22 the injectables revenues were up 22% YoY to \$64 mn. Annually, the company expects around 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. Overall Aurobindo has retained its guidance and expects the annual run rate for the injectable products to touch ~\$650-700 million over the next three years. In addition to the injectables, Aurobindo is planning to file 2 Biosimilars products in the oncology space in FY22 and looks to add 1-2 products every year. The filings would be done across the European as well as the US markets. The approval process for the said biosimilars requires around 7 months in Europe while it takes between 12-18 months in the US markets.

Q1FY2022 Conference call highlights

- ◆ Cronus Pharma specialties India Ltd: Aurobindo has entered in to a definitive agreement to subscribe for a fresh equity in Cronus Pharma Specialties India limited – a company engaged in the animal health space, amounting to RS 420 crores. Post the investment Aurobindo would hold 51% of the equity in Cronus
 - Cronus has a built up a sterile as well as non-sterile facility built for regulated markets in the SEZ and has manufacturing blocks for various dosage forms.
 - Cronus has a 67 products in its pipeline, of which 22 have been filed and 6 have been approved by the Centre for Veterinary Medicine, USFDA. Of the 67 products in its pipeline it has 40 injectables and balance 27 are non injectables.
 - Cronus has reported a turnover of Rs 6.6 crore and Rs 11.4 Crore for FY2020 and FY2021 respectively.
- ◆ Aurobindo is working on commercializing a multipeptide-based Covid19 vaccine in collaboration with a US-based vaccine company, which has applied for clinical trials in India. Aurobindo sees this as contract manufacturing opportunity.

- ◆ Aurobindo has approved amalgamation of its wholly owned subsidiaries Auronext Pharma Private Limited and Mviyes Pharma Ventures Private Limited with the company with an objective to reap operational synergies.
- ◆ US revenues, at Rs. 2681 crore, declined by 1.5% y-o-y (adjusting for Natrol Divestment) Aurobindo filed for 8 ANDAs with the USFDA in Q1FY2022 including 2 injectables. While the company received final approval for 4 ANDAs including 3 injectables. Aurobindo has launched 5 new products in the US markets including 2 injectable in the quarter.
- ◆ As on June 2021, the company cumulatively filed 654 ANDAs with the USFDA and received 480 approvals including 29 tentative approvals.
- ◆ EU formulations business revenues grew strong by 19.7% yoy to 1583 crore and constituted around 28% of the quarterly sales as compared to 24% in the corresponding quarter of the previous year.
- ◆ Anti-retroviral (ARV) revenues, declined sharply by 30.3% yoy to Rs 296 crores attributable to the higher stocking on advanced procurement in previous year due to possibilities of covid led uncertainties.
- ◆ Aurobindo's plants 1,9,7 and 11 are under the USFDA with an OAI/WL status. Of these plants – unit 1 was inspected by the USFDA and the inspection has ended with a Form 483 being issues with 7 observations. The management is working towards resolution of the same.

Result (Consolidated)

Particulars	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Revenues	5702.0	5924.8	-3.8	6001.5	-5.0%
Operating expenditure	4492.6	4667.4	-3.7	4726.8	-5.0%
Operating profit	1209.4	1257.4	-3.8	1274.7	-5.1%
Other income	81.3	93.4	-12.9	63.9	27.3%
EBIDTA	1290.7	1350.7	-4.4	1338.5	-3.6%
Interest	12.9	21.1	-38.9	18.2	-29.3%
Depreciation	279.7	255.5	9.5	266.0	5.1%
PBT	998.1	1074.1	-7.1	1054.3	-5.3%
Tax	247.7	301.2	-17.7	259.7	-4.6%
PAT	770.0	783.0	-1.7	800.1	-3.8%
EPS (Rs)	13.2	13.4	-1.7	13.7	-3.8%
Margins			BPS		BPS
OPM (%)	21.2	21.2	-1	21.2	-3
Adj PAT margin (%)	13.5	13.2	29	13.3	17
Tax rate (%)	24.8	28.0	-322	24.6	19

Source: Company, Sharekhan Research

Revenue mix

Particulars	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
USA	2681.0	2722.2	(1.5)	2861.5	(6.3)
Europe	1582.9	1322.2	19.7	1552.6	2.0
Growth Markets	329.3	289.6	13.7	305.7	7.7
ARV	296.4	425.5	(30.3)	491.2	(39.7)
Formulations	4889.6	4759.5	2.7	5211.0	(6.2)
Betalactams	383.6	500.3	(23.3)	408.6	(6.1)
Non Betalactams	428.3	279.8	53.1	385.7	11.0
API	811.9	780.1	4.1	794.3	2.2
Gross Sales	5701.5	5539.6	2.9	6005.3	(5.1)
Dossier Income	0.2	0.3	(33.3)	1.8	(88.9)
Sales	5701.7	5539.9	2.9	6007.1	(5.1)

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 the commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharma companies

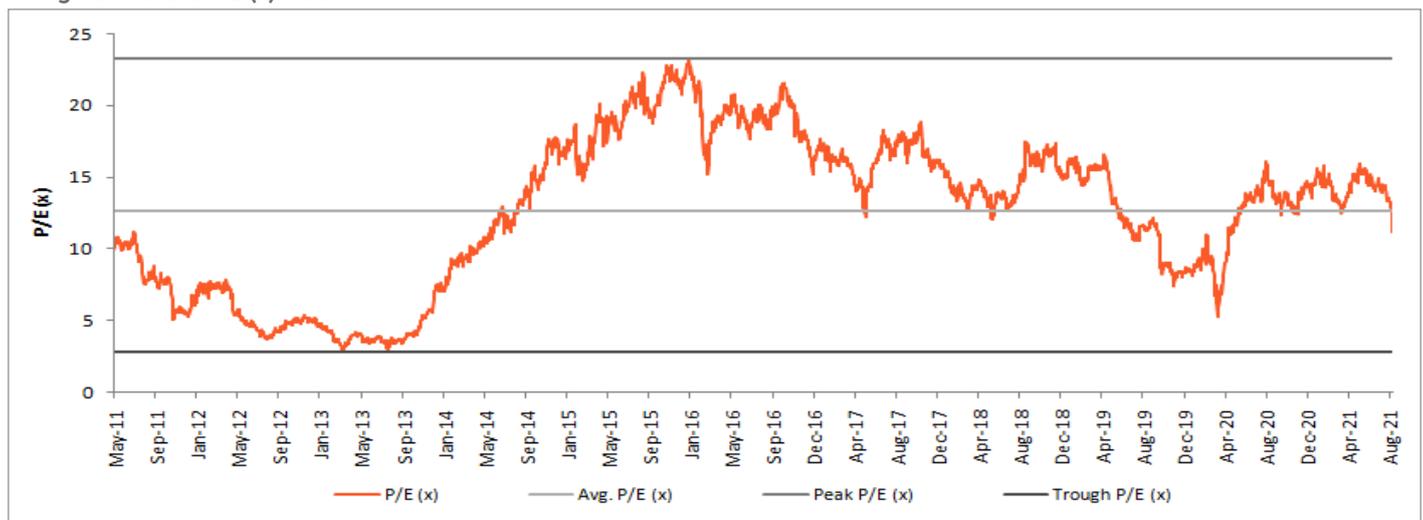
■ Company outlook - Near term headwinds emerge

over the long term a healthy growth outlook exists for the US business driven by an improving traction from the generic Injectables space (with comparatively low competition), a sturdy product pipeline and expected traction the recently launched products. However in the near term there are headwinds emerging for the US business in the form of price erosion and inventory buildup across channels. While the strong product pipeline planned for the US could enable partly mitigation of price erosion, the higher channel stocks are likely to pressurize the topline growth until the stocks normalize. The European business has a robust growth outlook backed by product portfolio expansion and expanding geographic reach. 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 a 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. Further, Aurobindo's vaccine manufacturing plant with a capacity of 450 mn doses is expected to be operational soon and the company has a tie up for vaccine manufacturing and is also exploring further opportunities for a tie up.

■ Valuation - Maintain Buy with a revised PT of Rs. 915

Aurobindo is witnessing multiple headwinds that have emerged especially for its US business such as higher price erosion and built of inventories across channels. These headwinds are expected to exert pressures on US revenues at least in the near term. While the company has plans to launch 30+ new products in US in FY2022, which could enable mitigate the impact of the price erosion, but lack of clarity exists around liquidation of higher channel stocks. The other geographies such as Europe have a strong growth outlook. Further Aurobindo is on track to file for its biosimilar products in FY2022. Also the injectables business is growing at a healthy pace and the company has retained its guidance of achieving a \$650-700 mn turnover over the next 3 years. Aurobindo's acquisition of 51% stake in Animal health company Cronus is at a substantially higher valuation. Given the weak performance in Q1FY2022 and emerging headwinds we have revised our estimates downwards for FY22E/FY23E and have also introduced FY24 estimates in this note. At CMP, the stock is trading at a valuation of 12.4x and 10.8x its FY22E and FY23E EPS, which is attractive. A possible de-merger of the injectables business could provide value unlocking opportunities. Hence we retain our Buy recommendation on the stock with a revised PT of Rs. 915.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Companies	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBITDA (x)			RoE (%)		
				FY21	FY22E	FY22E	FY21	FY22E	FY21	FY22E	FY21E	FY22E
Aurobindo Pharma	761.0	58.6	44,596.0	18.0	12.4	10.8	8.1	6.9	5.5	12.8	15.2	15.1
Lupin	977.0	45.2	44,334.0	36.4	26.6	19.5	18.9	11.5	8.4	8.8	11.0	13.3
Dr Reddy's	4,656.0	16.6	77,447.0	39.6	28.1	21.4	15.3	14.2	10.8	11.1	14.4	16.9

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 impact performance adversely going ahead, as more than 50% of the company's fillings are from plants that are under USFDA scrutiny. Further in the near term there are headwinds emerging for the US business in the form of price erosion and inventory buildup across channels. While the strong product pipeline planned for the US could enable partly mitigation of price erosion, the higher channel stocks are likely to pressurize the topline growth until the stocks normalize. 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.

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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