Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Aurobindo Pharma Ltd

Mixed Q4: Profitability to inch up with differentiated product launches

Pharmaceuticals	Sharekhan code: AUROPHARMA

Reco/View: Hold	↔	CMP: **Rs. 651**	Price Target: **Rs. 716**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↓	

ESG Disclosure Score NEW

ESG RISK RATING	32.2
Updated Apr 13, 2023	

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

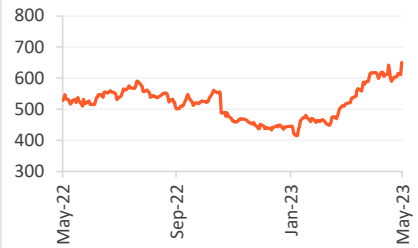
Company details

Market cap:	Rs. 38,531 cr
52-week high/low:	Rs. 663/647
NSE volume: (No of shares)	21.4 lakh
BSE code:	524804
NSE code:	AUROPHARMA
Free float: (No of shares)	28.2 cr

Shareholding (%)

Promoters	51.8
FII	23.0
DII	15.1
Others	10.06

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6.8	22.5	40.9	-2.8
Relative to Sensex	4.6	18.0	42.2	-15.2

Sharekhan Research, Bloomberg

Summary

- Aurobindo Pharma Limited (Aurobindo) reported a mixed Q4 as it outperformed on the revenue front. The company reported in-line performance on the operating profits front but underperformed on a net income basis.
- The company has been witnessing stronger growth in the U.S., Europe, growth markets, and APIs. The company has been seeing stabilisation in gross margins over the last three quarters.
- We believe the upside potential to the operating profitability is stronger, given the series of feasible drivers such as differentiated product launches, including gRevlimid, PenG, Biosimilars, expected continued growth in injectables, and regular new product launches in the U.S. likely over FY2024E-FY2025E.
- We maintain HOLD with a revised PT of Rs. 716. The company's shares are trading at ~13.0x/11.9x its FY2024E/FY2025E EPS, in line with its historical P/E.

Aurobindo Pharma Limited's (Aurobindo) Q4FY2023 performance was a mixed bag. The company reported an ~11.4% y-o-y rise in total revenue to Rs. 6,473 crore, while net sales increased by ~10.1% y-o-y to Rs. 6,378.7 crore (vs. our estimate of Rs. 6,169.7 crore and consensus estimate of Rs. 6,297.8 crore). The company has seen stronger-than-anticipated growth in the U.S., Europe, and emerging markets sales. EBITDA margin (on total revenue) declined by ~129bps y-o-y to ~15.5% in Q4FY2023. It was driven by higher growth in operating expenses compared with total revenue. As a result, EBITDA increased at a tepid pace of ~2.9% y-o-y to Rs. 1,002.2 crore (vs. our estimate of Rs. 987.1 crore and consensus estimate of Rs. 973.65 crore). The sharp rise in depreciation, interest cost, and taxes – partially offset by the equally sharp increase in other income – led to adjusted PAT declining by ~16.1% y-o-y to Rs. 483.6 crore (vs. our estimate of Rs. 511.9 crore and consensus estimate of Rs. 518.1 crore). Reported net profits declined by ~12.2% y-o-y to Rs. 506.3 crore. The upside potential to the operating profitability is higher, given the series of feasible drivers such as differentiated product launches, including gRevlimid, PenG, Biosimilars, expected continued growth in injectables, and regular new product launches in the U.S. likely over FY2024E-FY2025E.

Key positives

- Improved annualised growth in the U.S. and Europe and growth markets in Q4 when compared with Q3FY2023.
- Strong recovery in API sales in Q4FY2023 vs. Q3FY2023.
- Gross margin has stabilised over the past three quarters.

Key negatives

- The ARV segment's revenue declined by ~32.6% y-o-y in Q4FY2023.

Management Commentary

- Raw material and logistics costs have reduced in Q4FY2023. The company expects to see strong cash generation from FY2025 after the major capex will be over, while Eugia specialty performs, as well.
- The launch of gRevlimid likely by Q3FY2024 can drive growth and biosimilars by the end of FY2025 and Pen-G product sales coming in from Q1FY2024 will drive growth over the short-medium term.
- To reach the midpoint of 15-20% margins by FY2024-end.

Revision in estimates: The company has reached our estimates on the net income front, while outperforming on the operating profitability front for FY2023. We enhance FY2024E and FY2025E EPS estimates by ~13% and ~8%, respectively. We estimate its sales to report a ~7.7% and earnings to post a ~27.2% CAGR over FY2023-FY2025E.

Our Call

Valuation – Growth in the differentiated portfolio to aid margins growth, Maintain HOLD: Aurobindo has been witnessing stronger growth in the U.S., Europe, growth markets, and APIs. The company has been seeing stabilisation in gross margins over the last three quarters, which indicates likely stability in the product mix. The launch of gRevlimid planned in Q3FY2024 and biosimilars by the end of FY2025 and Pen-G product sales coming in from Q1FY2024 will drive strong profitable growth over the short-medium term. Injectables under Eugia are expected to grow in double digits and are expected to drive growth in the base business. The company plans to launch five new products every quarter as well in FY2024E and reach midpoint margins at 15.0-20.0% in FY2024E. At the CMP, the stock is trading at ~13.0x/11.9x its FY2024E/FY2025E EPS, which is in line with its historical P/E it has traded at. We maintain Hold on it with a revised price target (PT) of Rs. 716.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Total Income	23455.5	24855.4	26646.5	28811.9
Operating profit	4386.8	3758.2	4743.1	5272.6
OPM (%)	18.7	15.1	17.8	18.3
Adj. PAT	2737.5	1978.8	2927.0	3199.1
EPS (Rs)	46.7	33.8	50.0	54.6
PER (x)	13.9	19.3	13.0	11.9
EV/EBITDA (x)	8.4	9.9	4.4	3.2
P/BV (x)	1.6	1.4	1.3	1.2
ROCE (%)	12.9	9.3	11.4	12.0
RONW (%)	11.8	7.7	10.4	10.3

Source: Company; Sharekhan estimates

Q4FY2023 mixed results: Aurobindo reported ~11.4% y-o-y rise in total revenue to Rs. 6,473 crore, while net sales increased by ~10.1% y-o-y to Rs. 6,378.7 crore (vs. our estimate of Rs. 6,169.7 crore and consensus estimate of Rs. 6,297.8 crore). This was driven by stronger-than-expected rise of ~11.6% y-o-y in the U.S. revenue to Rs. 3,045 crore; ~7.7% y-o-y rise in Europe revenue to Rs. 1,660 crore; ~51.3% y-o-y increase in emerging market revenue to Rs. 592 crore; and ~11.4% y-o-y rise in API revenue to Rs. 1,017 crore – partially offset by the ~32.6% y-o-y decline in ARV sales to Rs. 159 crore for Q4FY2023. Gross profits margin (GPM) declined ~183 bps y-o-y (on total revenue) to ~54.7% in Q4FY2023. This indicates likely unfavourable products mix. Gross profit increased by ~7.8% y-o-y to Rs. 3,542 crore. EBITDA margin (on total revenue) declined by ~129bps y-o-y (+59bps q-o-q) to ~15.5% in Q4FY2023. It was driven by higher growth in operating expenses than growth in total revenue. As a result, EBITDA increased at a tepid pace of ~2.9% y-o-y to Rs. 1,002.2 crore (vs. our estimate of Rs. 987.1 crore and consensus estimate of Rs. 973.65 crore). With sharp rise in depreciation, interest costs, and taxes – partially offset by the equally sharp increase in other income, led to adjusted PAT declining by ~16.1% y-o-y to Rs. 483.6 crore (vs. our estimate of Rs. 511.9 crore and consensus estimate of Rs. 518.1 crore). Reported net profit declined by ~12.2% y-o-y to Rs. 506.3 crore.

Q4FY2023 Conference Call Highlights

Outlook: The company hopes that its biosimilar products will contribute to margin expansion from FY2025E. The new pipeline of products will include high-margin new generation products. Pricing has stabilized in the U.S. and there is likely to be a normalcy in it. Raw-material and logistics costs have reduced in Q4FY2023. The company expects to see strong cash generation from FY2025 after the major capex will be over, while Eugia specialty performs, as well. The company expects to maintain ~USD 25- 30 million a quarter run rate for branded injectables in the U.S. R&D spend is expected to be at 6.0-6.5% and the company will be incurring USD400 crore per quarter towards it. The launch of gRevlimid can drive growth and biosimilars by the end of FY2025 and Pen-G product sales coming in from Q1FY2024 will drive growth over the short-medium term. Injectables under Eugia will grow in double digits as well, which can drive base business growth. The company plans to launch five new products every quarter. The company has filed five products from China plant (OSDs) and is doing the exhibit batches and will be starting with European dispatches. European manufacturing will begin from Q1FY2025 and from Q3FY2025 or Q4FY2025 for China market.

gRevlimid: gRevlimid will be launched in October 2023 or in Q3FY2024 and the company expects the pricing to be stable as it is a limited quantity opportunity until the patent on it expires in January 2026.

Outlook on margins: To reach the midpoint of 15%-20% margins by FY2024-end.

Biosimilars: Trastuzumab biosimilar's treatment phase of the trial is over and the filings of the same are likely to start in emerging markets in June or July 2023. The first such filing of the product is likely in India and European Medical Agency in September 2023 and with the USFDA by Q4FY2024. Xolair (Omalizumab) biosimilar's phase III clinical trial is over – its patent would expire in November 2025. The company believes it is a USD4.0 billion product and a limited competition opportunity and will be filing for it in 2025.

Price erosion: First 3 quarters of the year had high price erosions and Q4FY23 was stable subsequently.

Financials for Q4FY2023 and FY2023: The company registered revenue of Rs. 6,473 crore, up 11.4% y-o-y, for Q4FY2023, while EBITDA before Forex and other income grew by ~2.8% y-o-y and by ~5.0% q-o-q to Rs. 1,002.2 crore. EBITDA margin stood at ~15.5% for Q4FY2023 and ~15.1% for FY2023. Net profit increased by ~3% q-o-q to Rs. 505.9 crore. EBITDA margin before R&D stood at ~21.8% for Q4FY2023 vs. ~21.4% for Q4FY2022. The formulations business grew at ~11.4% y-o-y to Rs. 5,455 crore and contributed ~84.3% to the total revenue. API contributed ~15.7% and revenue was Rs. 1,017 crore for Q4FY2023, up ~11.4% y-o-y, led by improved demand for some of its key products. Revenue from the U.S. formulations increased ~11.6% y-o-y to Rs. 3,045 crore, while on a constant currency basis, U.S. revenue increased by ~2.0% y-o-y to USD370 million. The company witnessed Rs. 20-25 crore of one-offs each in Q4FY2023 in both sales and profits, respectively, on account of claw-back taxes in Europe, which reduced gross and EBITDA margins, respectively. The company received PLI incentives of Rs. 48 crore, as sales of the eligible products have picked up.

Product pipeline: Aurobindo has received final approval for ~26 ANDAs and launched ~10 ANDA products in Q4FY2023. The company has filed for ~12 ANDAs, including ~3 injectables in Q4FY2023. The company has 774 ANDAs on a cumulative basis filed with the USFDA, out of which 565 are final approvals and 34 have tentative approvals, including eight ANDAs, which are tentatively approved under PEPFAR and the balance 175 ANDAs are under review. Aurobindo is conducting clinical research at phase III stage for biosimilar products and is likely to commission the plant soon for the same with a budget of Rs. 300-400 crore.

R&D spend, forex rate, and cost of funding: R&D spend stood at ~6.3% of revenue for the quarter and ~5.7% of revenue for FY2023. Forex rate stood at USD82.19 in Q4FY2023 vs. USD82.10 as of Q3FY2023. The average funding cost was at 4%, mainly due to availing of multiple currency loans.

Capex: Net capex for the quarter stood at USD105 million, of which capex for the existing business was USD62 million, including USD14 million for ANDA purchases. PLI capex till date has been USD121.0 million as of March 2023. The same is likely to be over by the end of FY2024. The company has spent Rs. 1,900 crore on biosimilar products till date. The company may continue to do de-bottlenecking and maintenance capex though. The company also plans to acquire ANDAs to leverage the existing capacity and resources. For FY2024, Aurobindo will be spending USD120-130 million for the existing plants and incrementally spend USD75-100 million on new capacity.

U.S. injectables business: Aurobindo Pharma USA's revenue increased by ~1.0% q-o-q. Revenue of the U.S. injectable business increased by ~3% y-o-y and ~18% q-o-q to USD71.9 million in Q4FY20023. The total Eugia specialty sales in the U.S., including the specialty OSD, amounted to ~USD81 million during Q4FY2023. During Q4FY2023, Eugia performance has been better on various financial parameters q-o-q. The company has 171 injectable ANDAs filed in FY2023, of which 171 injectables have received final approvals and the remaining 45 are under review or have tentative approvals. The first two quarters of FY2023 were challenging and the company witnessed double-digit price decline, unheard of in injectables. Although it stabilised from Q3FY2023, as the pricing decline was almost negligible. Drug shortage in the U.S. is at its highest level. This coupled with new launches should help it grow. For FY2024, gross margins in Eugia should be between USD60 million to USD70 million and EBITDA levels will be around USD25 million to USD35 million.

Income from investments and FCF: The company has reported an income of Rs. 74 crore for the quarter and Rs. 148 crore for FY2023. The business generated FCF of Rs. 61 million in Q4FY2023 as a result of strong cash flows generated in the quarter. It was the result of a good collection of receivables in March 2023. Net cash stood at USD194 million at the end of Q4FY2023.

Gross debt: Gross debt stood at USD591.7 million, and the company plans to reduce debt going forward.

Facility status: Out of the eight USFDA regulated API plants, six have got VAI status, while one unit was inspected recently and has received a warning letter. Major plants under commissioning include three plants, including Eugia plant under commissioning in the U.S. Part of it was commissioned in March 2023. The rest is expected to be commissioned by FY2023 and or during FY2025. China's plant is fully installed and is likely to be commissioned by Q1FY2025. The company is in the process of manufacturing the exhibit batches. The Pen-G plant is expected to be completed in CY2023, but the company intends to commission it ahead of its schedule.

Results (Consolidated) Rs cr

Particulars	Q4FY23	Q4FY22	YoY %	Q3FY23	QoQ %
Total Income	6,473.0	5,809.4	11.4	6,407.1	1.0%
Operating expenditure	5,470.8	4,835.0	13.2	5,452.7	0.3%
EBITDA	1,002.2	974.4	2.9	954.4	5.0%
Depreciation	345.6	253.6	36.3	321.4	7.5%
EBIT	656.6	720.8	-8.9	633.0	3.7%
Interest	55.6	9.2	503.7	45.0	23.7%
Other income	112.3	29.2	285.0	80.5	39.4%
PBT	713.3	740.8	-3.7	668.6	6.7%
Tax	224.2	17.5	1181.6	189.1	18.5%
MI and Income from Associates	-5.5	3.8	NM	-0.3	NM
Adjusted PAT	483.6	576.5	-16.1	479.1	0.9%
Exceptional Items	-22.7	0.0	NM	-12.1	NM
Reported PAT	506.3	576.5	-12.2	491.3	3.1%
Margins			**BPS**		**BPS**
EBIDTA margin (%)	15.5	16.8	-129	14.9	59
EBIT (%)	10.1	12.4	-226	9.9	26
Adj. PAT margin (%)	7.5	9.9	-245	7.5	-1
Tax rate (%)	31.4	2.4	2906	28.3	314

Source: Company, Sharekhan Research

Revenue mix Rs cr

Particulars	Q4FY23	Q4FY22	YoY %	Q3FY23	QoQ %
U.S.	3,045.0	2,728.0	11.6	3,001.0	1.5
Europe	1,660.0	1,541.0	7.7	1,701.0	(2.4)
Growth Markets	592.0	391.0	51.4	499.0	18.6
ARV	159.0	236.0	(32.6)	251.0	(36.7)
Formulations	**5,456**	**4,896.0**	**11.4**	**5,452.0**	**0.1**
Beta lactams	638	594.0	7.4	623.0	2.4
Non Betalactums	379	319.0	18.8	332.0	14.2
API	**1,017**	**913.0**	**11.4**	**955.0**	**6.5**
Gross Sales	**6,473**	**5,809.0**	**11.4**	**6,407.0**	**1.0**
Dossier Income	0.0	0.0	-	0.0	-
Net Sales	**6,473**	**5,809.0**	**11.4**	**6,407.0**	**1.0**

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Regulatory concerns and pricing erosion prove a hurdle over the short-medium term

Over the years, Indian pharmaceutical companies have established themselves as a dependable source for global pharma companies. The confluence of other factors, including focus on specialty/complex products in addition to emerging opportunities in the API space would be key growth drivers over the long term. However, ongoing USFDA plant inspections and a few companies being issued Form 483 with observations point to apparent regulatory concerns. We believe, in the near term, based on the headwinds that may drag the performance, especially in the API and CDMO space and for large pharma players seeing USFDA OAI or WL status on their facilities, we have a Neutral view of the sector.

■ Company outlook - Outlook – Uncertainties likely to stay in the near term

Over the long term, a healthy growth outlook exists for the U.S. business, driven by improving traction from the generic injectables space (with comparatively low competition), a sturdy product pipeline, and expected traction in the recently launched products. However, headwinds for the U.S. business are in the form of price erosion and inventory buildup across channels in the industry, which management believes would ease out gradually in the subsequent quarters. While the strong product pipeline planned for the U.S. could partly enable mitigation of price erosion, higher channel stocks are likely to pressurise topline growth until the stocks normalise. The European business has a healthy growth outlook, backed by product portfolio expansion and expanding geographic reach. However, some moderation in growth is expected and FY2024 is expected to post strong growth, backed by product portfolio expansion and tapping new geographies. However, Aurobindo is awaiting USFDA clearance for its plants and 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 its presence in the specialty segment, which includes areas of injectables, biosimilars, oncology inhalers, and transdermal patches among others, which is likely to support growth. Moreover, a possible demerger of the injectables business could provide a value-unlocking opportunity. However, in the medium term, challenges in the form of price erosion and cost pressures are likely to stay and could overweigh margin performance.

■ Valuation - Growth in the differentiated portfolio to aid margins growth, Maintain HOLD

Aurobindo has been witnessing stronger growth in the U.S., Europe, growth markets, and APIs. The company has been seeing stabilisation in gross margins over the last three quarters, which indicates likely stability in the product mix. The launch of gRevlimid planned in Q3FY2024 and biosimilars by the end of FY2025 and Pen-G product sales coming in from Q1FY2024 will drive strong profitable growth over the short-medium term. Injectables under Eugia are expected to grow in double digits and are expected to drive growth in the base business. The company plans to launch five new products every quarter as well in FY2024E and reach midpoint margins at 15.0-20.0% in FY2024E. At the CMP, the stock is trading at ~13.0x/11.9x its FY2024E/ FY2025E EPS, which is in line with its historical P/E it has traded at. We maintain Hold on it with a revised price target (PT) of Rs. 716.

Peer Comparison

Companies	CMP (Rs / Share)	O/S Shares (Crs)	Mcap (Rs Cr)	P/E (x)			EV / EBITDA (x)			RoE (%)		
				FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Aurobindo Pharma	650.8	58.6	38,607.0	19.3	13.0	11.9	9.9	4.4	3.2	7.7	10.4	10.3
Divis Laboratories	3,487.0	26.5	92,621	50.8	42.3	37.5	38.2	30.5	26.3	14.3	14.6	14.2

Source: Company; Sharekhan Research

About company

Hyderabad-based Aurobindo was incorporated in 1986 and manufactures generic formulations and APIs. Aurobindo generates 90% of its sales from international markets. The company currently holds a strong position in the U.S., where it is the fifth largest generic pharmaceutical company as per the IMS National Prescription Audit, measured by total prescriptions dispensed for 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 U.S. presence with the acquisition of dermatology and oral solid businesses from Sandoz.

Investment theme

Aurobindo is one of the largest pharma players with a large share of revenue from the U.S. having one of the highest ANDA filings. However, it is grappling with the pricing pressure in its OSD segment, wherein it has a stronghold. Nevertheless, it is seeing an uptick in its complex and specialty injectables revenue share in the U.S. With an increased share of the injectables and biosimilar products revenue, it should be able to stabilise its margins over the medium term. However, currently, it is experiencing margin pressures due to increased expenses and uneven sales 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

Mr. K. Ragunathan	Chairperson
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	2.97
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	0.40

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

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by BNP PARIBAS

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