Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Aurobindo Pharma Ltd

USFDA Overhang – Downgrade to Hold

Pharmaceuticals	Sharekhan code: AUROPHARMA

Reco/View: Hold ↓	CMP: **Rs. 1,053**	Price Target: **Rs. 1,133** ↓

↓ 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		↓	

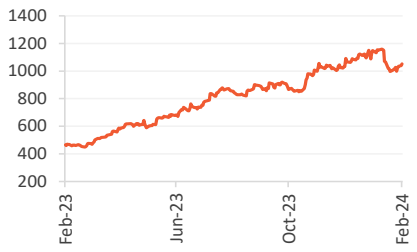
Company details

Market cap:	Rs. 61,497 cr
52-week high/low:	Rs. 1177/443
NSE volume: (No of shares)	17,558
BSE code:	524804
NSE code:	AUROPHARMA
Free float: (No of shares)	28.1 cr

Shareholding (%)

Promoters	51.8
FII	1.0
DII	17.9
Others	29.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-8.0	2.6	25.0	126.5
Relative to Sensex	-10.3	-8.3	13.0	106.1

Sharekhan Research, Bloomberg

Summary

- Aurobindo reported a good Q3, as it outperformed our estimates on EBITDA and PAT front where sales grew by 13.8% YoY to Rs 727 crs (1% below our estimates), EBITDA grew by 67% y-o-y to Rs. 1,601 crore (3.7% above our estimates) and adjusted PAT grew by 86% y-o-y to Rs. 895 crore.
- The surge in sales was led by 25% y-o-y growth in the U.S region (highest ever cc sales of US$ 458 mn), followed by 13% y-o-y growth in the Europe business (cc sales of Euro 200mn).
- Healthy product mix led by gRevlimid (US$ 20 mn) resulted in a 220bps increase in gross margin to 56.7% and subsequently increased EBITDA margin by 610bps to 20.7% in Q3FY2024.
- This closure of lines in Eugia Unit-3 costs Aurobindo USD20 million and USD2-3 million remediation cost per month. We believe the shutdown of lines will impact Aurobindo's sales and there is no clarity on these lines opening in early FY25E. Hence, we downgrade the stock to HOLD. At the CMP, the stock is trading at ~18.3x/15x its FY2025E/FY2026E EPS, we would like to allot a P/E of 16x to arrive at a TP of Rs. 1,133.

Aurobindo Pharma reported a good set of numbers in Q3FY2024, beating our estimates on EBITDA and PAT basis. The company reported a ~14% y-o-y rise in total revenue to Rs. 7,351 crore, led by stronger-than-anticipated growth in all markets like the U.S. (51% of sales). U.S. sales growth reported 25% growth at Rs. 3,756 crore, driven by 1) healthy growth of 35% y-o-y in oral solids reflecting stability in price erosion in the base portfolio, 2) 57% y-o-y growth in the injectable business led by gRevlimid, and 3) 20% q-o-q growth in branded oncology. The healthy product mix resulted in EBITDA growth of 62% y-o-y to Rs. 15,520 crore and a 610bps increase in EBITDA margin to 20.7%. Healthy operations led to PAT growth of 91% y-o-y after adjusting for forex to Rs. 940 crore. Going forward, the closure of a few lines of its subsidiary Eugia's Unit-3 would cost Aurobindo USD20 million, followed by a remediation cost of USD2-3 million per month. This would impact overall operations. Hence, we downgrade the stock to HOLD.

Key positives

- EBITDA margin was 90bps above our estimate at 20.7%.
- U.S. CC revenue was the highest ever at USD458 million in Q3FY2024.
- Emerging market sales grew 13% y-o-y to Rs. 627 crore, 11% above our estimates.

Key negatives

- Sales stood below our estimates due to lower Europe sales, which were impacted by one-off tax payment and lower-than-expected ARV sales.

Management Commentary

- Revenue from injectable and specialty businesses increased by 58% y-o-y to USD112 million in Q3FY2024. The y-o-y growth was driven by new product launches. Total injectable and specialty sales globally increased by 46.8% and stood at USD150 million.
- The company has 216 injectable and specialty ANDA filings as of December 31, 2023, out of which 164 have received final approval, and the remaining 52 are under review or have tentative approvals.
- Net capex for the quarter was USD103 million, which mainly includes approximately USD37 million towards the PLI project. The cumulative capex for the Pen-G project, till December 31, 2023, amounts to approximately USD230 million.

Revision in estimates – The company's Eugia Unit-3 plant has voluntarily shut down a few lines, which is expected to have a USD20 million impact on U.S. sales, and the remediation cost would further lower profitability. Hence, we are downgrading our EPS estimates by 2%, 7%, and 4% in FY2024E, FY2025E, and FY2026E to Rs. 53, Rs. 57.7, and Rs.70 per share, respectively.

Our Call

Valuation – Downgrade to HOLD with a revised PT of Rs. 1,133: Aurobindo has been witnessing stronger growth in the U.S., driven by gRevlimid-led injectable portfolio and improvement in the base business followed by strong traction in the emerging market portfolio. The company has seen an increase in EBITDA margins over the past six quarters, which indicates stability in the product mix. In the recent inspection of its Subsidiary Unit-3, the company has voluntarily closed its lines to maintain compliance with USFDA regulations. This closure of lines is expected to cost Aurobindo USD20 million and US2-3 million remediation costs per month. We believe the shutdown of lines will Impact Aurobindo's sales and there is no surety of the lines opening in early FY2025E. Hence, we downgrade the stock to HOLD. At the CMP, the stock is trading at ~18x/15x its FY2025E/FY2026E EPS due to the overhang of USFDA offsetting growth in the oral solids business in the U.S. region. We would like to ascribe a P/E of 16x to arrive at a target price (TP) of Rs. 1,133.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY2022	FY2023	FY2024E	FY2025E	FY2025E
Total Income	23455.5	24855.4	27521.0	30289.2	34057.6
Operating profits	4386.8	3758.2	5229.0	5982.1	6981.8
OPM (%)	18.7	15.1	19.0	19.8	20.5
Adj. PAT	2737.5	1978.8	3143.3	3378.4	4099.4
EPS (Rs)	46.7	33.8	53.6	57.7	70.0
PER (x)	22.5	31.2	19.6	18.3	15.0
EV/Ebidta (x)	13.8	16.2	8.4	6.7	5.0
P/BV (x)	2.5	2.3	2.1	1.9	1.7
ROCE (%)	12.9	9.3	12.8	12.6	13.9
RONW (%)	11.8	7.7	11.1	10.8	11.7

Source: Company; Sharekhan estimates

Q3FY2024 Conference Call Highlights

Outlook: The company hopes that its biosimilar products will contribute to margin expansion from FY2026E. The new pipeline of products will include high-margin new-generation products. Pricing has stabilised in the U.S. and there is likely to be a normalcy in it. Raw-material and logistics costs have been reduced in Q3FY2024. The company expects to see strong cash generation from FY2025 after the major capex is over, while Eugia specialty performs as well. Injectables under Eugia will grow in double digits as well, which can drive growth of the base business. The company has filed five products from the China plant (OSDs) and is doing the exhibit batches and will be starting with European dispatches.

gRevlimid: The company reported sales of USD20million from gRevlimid, which was launched in October 2023.

Outlook on margins: EBITDA margin to increase above 20% ex. of biosimilars in FY2024E.

Biosimilars – The company has received first approval from CuraTeQ Biologics in the biosimilars business. The company has received SEC approval for Trastuzumab, which is an anti-HER2 breast cancer drug in India. The company has three filings done with European Medicines Agency, including Trastuzumab. A spate of other filings with Trastuzumab is likely to follow in emerging markets, including that of the U.S. in the next quarter.

Aurobindo has initiated Phase-3 clinical trial of Omalizumab biosimilar (USD4.3 billion sales) in Europe across multiple countries and sites there. Omalizumab references Xolair, which is an injectable drug that targets and blocks immunoglobulin E.

The company has in-licensed an innovative biologic drug – Ryzneuta (indicated for chemotherapy-led neutropenia and is equivalent to a well-known drug – Pegfilgrastim with U.S. sales of ~USD1.5 billion) from a US-based player – Evive Biotech, and it would commercialise the drug during H2FY2025 as the CMO's plant has already been inspected by the USFDA and received approval on November 16, 2023. The company expects to launch this biosimilar in July 2024.

Product pipeline: The company expects to launch 40 new products in the next 12 months.

R&D spend, forex rate, and cost of funding: R&D spend is expected to be 5-6% of sales.

Capex: Net capex for the quarter was USD103 million, which mainly includes approximately USD37 million towards the PLI project. The cumulative capex for the Pen-G project, till December 31, 2023, amounts to approximately USD230 million.

Results (Consolidated) **Rs cr**

Particulars	Q3FY24	Q3FY23	YoY %	Q2FY24	QoQ %
Total Income	7,351.8	6,407.1	14.7	7,219.4	1.8%
Operating expenditure	5,750.5	5,452.7	5.5	5,817.2	-1.1%
EBITDA	1,601.3	954.4	67.8	1,402.2	14.2%
Depreciation	423.3	321.4	31.7	300.0	41.1%
EBIT	1,178.0	633.0	86.1	1,102.2	6.9%
Interest	75.6	45.0	68.0	55.0	37.4%
Other income	117.4	80.5	45.7	80.0	46.7%
PBT ex forex	1,219.8	668.6	82.5	1,127.2	8.2%
Tax	322.5	189.1	70.5	223.2	44.5%
MI and Income from Associates	-1.8	-0.3	NM	-1.8	NM
Adjusted PAT	895.5	479.1	86.9	902.2	-0.7%
Exceptional Items	-45.1	-12.1	NM	0.0	NM
Reported PAT	940.7	492.0	91.2	757.0	24.3%
Margins			**BPS**		**BPS**
EBIDTA margin (%)	21.8	14.9	688	19.4	236
EBIT (%)	16.0	9.9	614	15.3	76
Adj PAT margin (%)	12.2	7.5	470	12.5	-32
Tax rate (%)	26.4	28.3	-185	19.8	664

Source: Company, Sharekhan Research

Revenue mix **Rs cr**

Particulars	Q3FY24	Q3FY23	YoY %	Q2FY24	QoQ %
USA	3,756.0	3,001.2	25.1	3,385.0	11.0
Europe	1,728.0	1,701.2	1.6	1,769.0	(2.3)
Emerging Markets	627.0	498.9	25.7	564.0	11.2
ARV	179.0	251.2	(28.7)	250.0	(28.4)
Formulations	**6,290**	**5,453**	**15.4**	**5,968**	**5.4**
Betalactums	737	623	18.3	816	(9.7)
Non Betalactums	285	332	(14.0)	350	(18.6)
API	**1,022**	**955**	**7.1**	**1,166**	**(12.3)**
Gross Sales	**7,312**	**6,407**	**14.1**	**7,134**	**2.5**
Dossier Income	0.0	0.0	-	0.0	-
Net Sales	**7,312**	**6,407**	**14.1**	**7,134**	**2.5**

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Input cost easing with companies focusing on complex product launches

Over the years, Indian pharmaceutical companies have established themselves as a dependable source for global peers. A confluence of other factors, including a focus on specialty/complex products in addition to emerging opportunities in the API space, would be key growth drivers over the long term. The sector is witnessing an easing of input costs – of raw material, freight, and power, which should aid the sector in expanding margins. The sector is also witnessing an easing of price erosion, followed by increasing contributions from new product launches. We believe the sector is in a sweet spot where it is experiencing a healthy product mix and cost rationalisation, which increases operational profit of the companies. The sector is primarily a low-debt sector with increasing operational profit and the benefit of a low tax rate due to its operations in the SEZ sector, so we remain optimistic about the sector overall.

■ 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 an 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 - Downgrade to HOLD with a revised PT of Rs. 1,133

Aurobindo has been witnessing stronger growth in the U.S., driven by gRevlimid-led injectable portfolio and improvement in the base business followed by strong traction in the emerging market portfolio. The company has seen an increase in EBITDA margins over the past six quarters, which indicates stability in the product mix. In the recent inspection of its Subsidiary Unit-3, the company has voluntarily closed its lines to maintain compliance with USFDA regulations. This closure of lines is expected to cost Aurobindo USD20 million and US2-3 million remediation costs per month. We believe the shutdown of lines will Impact Aurobindo's sales and there is no surety of the lines opening in early FY2025E. Hence, we downgrade the stock to HOLD. At the CMP, the stock is trading at ~18x/15x its FY2025E/FY2026E EPS due to the overhang of USFDA offsetting growth in the oral solids business in the U.S. region. We would like to ascribe a P/E of 16x to arrive at a TP of Rs. 1,133.

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, the company 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

K. Ragunathan	Chairperson
K. Nithyananda Reddy	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	LIFE INSURANCE CORPORATION OF INDIA	5.57
2	HDFC TRUSTEE COMPANY LTD.	2.94
3	MIRAE ASSET EMERGING BLUECHIP FUND	1.69
4	BNP PARIBAS ARBITRAGE	1.22
5	INVESCO PACIFIC FUND (U.K.)	1.05

Source: BSE

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

DISCLAIMER

This information/document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This information/ document is subject to changes without prior notice.

Recommendation in reports based on technical and derivatives analysis is based on studying charts of a stock's price movement, trading volume, outstanding positions, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals. However, this would only apply for information/document focused on technical and derivatives research and shall not apply to reports/documents/ information focused on fundamental research.

This information/document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this information/report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved) and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other recommendations/ reports that are inconsistent with and reach different conclusions from the information presented in this recommendations/report.

This information/recommendation/report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst might have dealt or traded directly or indirectly in securities of the company and that all the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst and SHAREKHAN further certifies that either he or his relatives or Sharekhan associates might have direct or indirect financial interest or might have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report. The analyst and SHAREKHAN encourages independence in research report/ material preparation and strives to minimize conflict in preparation of research report. The analyst and SHAREKHAN does not have any material conflict of interest or has not served as officer, director or employee or engaged in market making activity of the company. The analyst and SHAREKHAN has not been a part of the team which has managed or co-managed the public offerings of the company, and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Ltd or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Forward-looking statements (if any) are provided to allow potential investors the opportunity to understand management's beliefs and opinions in respect of the future so that they may use such beliefs and opinions as one factor in evaluating an investment. These statements are not a guarantee of future performance and undue reliance should not be placed on them. Such forward-looking statements necessarily involve known and unknown risks and uncertainties, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or result expressed or implied by such forward-looking statements. Sharekhan/its affiliates undertakes no obligation to update forward-looking statements if circumstances or management's estimates or opinions should change except as required by applicable securities laws. The reader/investors are cautioned not to place undue reliance on forward-looking statements and use their independent judgement before taking any investment decision.

Investment in securities market are subject to market risks, read all the related documents carefully before investing. The securities quoted are for illustration only and are not recommendatory. Registration granted by SEBI, and certification from NISM in no way guarantee performance of the intermediary or provide any assurance of returns to investors.

Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on www.sharekhan.com

---

Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Correspondence/Administrative Office: Gigaplex IT Park, Unit No 1001, 10th Floor, Building No.9, TTC Industrial Area, Digha, Airoli-West, Navi Mumbai – 400 708. Tel: 022 61169000 / 61150000, Fax No. 61169699.

Other registrations of Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669.

Compliance Officer: Ms. Binkle Oza; Tel: 022-62263303; email id: complianceofficer@sharekhan.com

For any complaints/grievance, email us at igc@sharekhan.com or you may even call Customer Service desk on - 022- 41523200 / 022-69920600