COMPANY UPDATE

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 1,900 | ⮝ 18%

AJANTA PHARMA | Pharmaceuticals | 21 September 2020

NDR takeaways – Earnings drivers tracking well

We hosted investor meetings with the management of Ajanta Pharma (AJP). AJP expects significant earnings acceleration over the next 3-4 years (>25% CAGR per our estimates). Key drivers include brand franchise recovery (India+EM), high-teens growth in the US, operating leverage from the new facility and capex tailwinds. We expect these factors to bolster operating margins to 30% by FY23 (27% in FY20), aiding a stock rerating. Raise FY21-FY23 EPS by 3-5% and Sep'21 TP to Rs 1,900 (vs. Rs 1,730). BUY.

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India business; FY21 decline but >10% growth from FY22: Sales improved marginally in Q1FY21 led by gradual recovery in the acute portfolio (dermatology, ophthalmology). The chronic business is doing well, and MR activity has returned to normal. Trade generic share has picked up from 3% in Q1 to ~5% now and is likely to be capped at this level. In Jul/Aug'20, India sales grew 9.4%/8% vs. 0.2%/−2.2% for industry, per AIOCD. AJP expects a 5-6% decline in FY21 sales and >10% growth beyond.

US business- key 2H launches: Some of the key H2 launches planned for the US are Tamiflu suspension and Divalproex DR (both 4-5-player markets). AJP pegs revenue potential for each at US$ 5mn-6mn and expects >20% US growth in FY21. Strong pipeline visibility should drive high-teens growth in the next 3-4 years. Management expects US EBITDA margins of >25% by FY23.

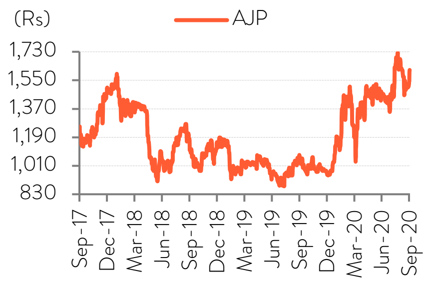
EM – facing resistance: Branded EM business (Asia, Africa) is slowing due to Covid restrictions; hence growth for the rest of Q2 could be moderate (Q1: >23% YoY). AJP expects EM growth of 7-8% in FY21. Tender business outlook in Africa markets is muted at least in next two years.

...(continued in next page)

Ticker/Price	AJP IN/Rs 1,613
Market cap	US$ 1.9bn
Shares o/s	88mn
3M ADV	US$ 4.4mn
52wk high/low	Rs 1,760/Rs 903
Promoter/FPI/DII	71%/9%/9%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	20,553	25,878	27,199	31,046	35,317
EBITDA (Rs mn)	5,653	6,944	7,597	8,870	10,434
Adj. net profit (Rs mn)	3,869	4,082	4,888	6,147	7,599
Adj. EPS (Rs)	44.1	46.6	55.7	70.1	86.6
Adj. EPS growth (%)	(17.4)	5.5	19.7	25.7	23.6
Adj. ROAE (%)	17.8	16.6	17.1	18.7	19.8
Adj. P/E (x)	36.6	34.7	28.9	23.0	18.6
EV/EBITDA (x)	24.9	20.3	18.5	15.7	13.1

Source: Company, BOBCAPS Research

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EBITDA margin of 28% for Q2-Q4FY21

MR activity has fully normalised and R&D is at 50% levels; thus, a majority of the temporary cost savings seen in Q1FY21 would return in Q2 itself. SGA spends could rise ~15% from the low Q1 base. Management expects EBITDA margins for the rest of FY21 at ~28% (Q1: 33%), partly led by reversal of currency benefits (USDINR at 73.5 vs. 75 in Q1). Higher contribution on the US business could aid new-normal gross margins of 75%. AJP believes EBITDA margins in FY22 would match that in FY21 before rising to ~30% by FY23, led by operation efficiency in India and operating leverage in the US.

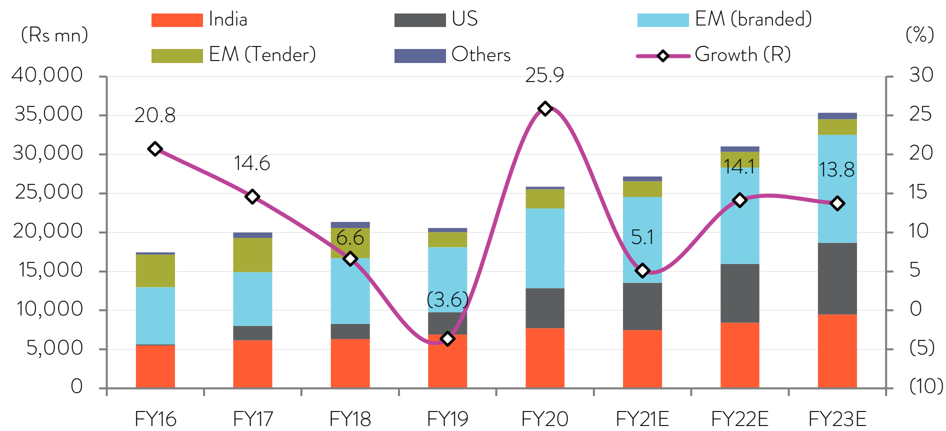
Capex tailwinds – last block to go onstream by Dec'20

The company plans to commercialise the ophthalmology block at Guwahati in Assam (capex – Rs 1bn) in Dec'20. This could lead to higher depreciation in Q4. Thereafter, management does not intend any major capacity expansion for the next four years at least, except for maintenance capex (Rs 1bn-1.25bn annually).

We expect 14% sales CAGR over FY21-FY23

Branded (India+EM) and US to be key drivers

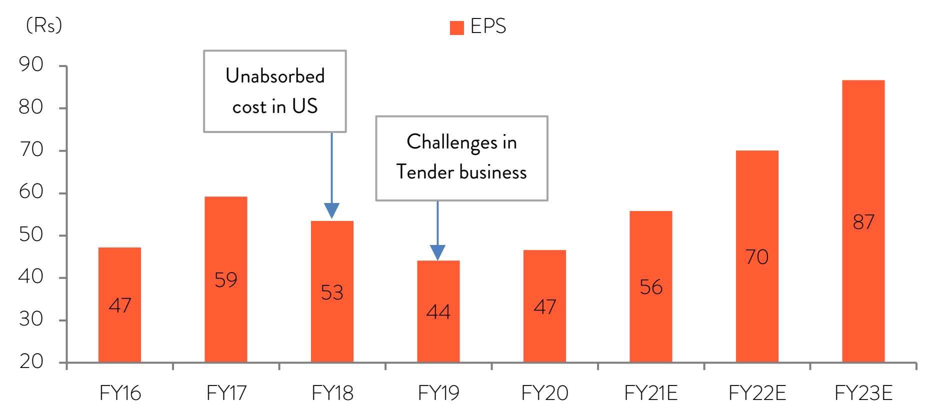
FIG 1 – SALES MIX GROWTH



Source: Company, BOBCAPS Research

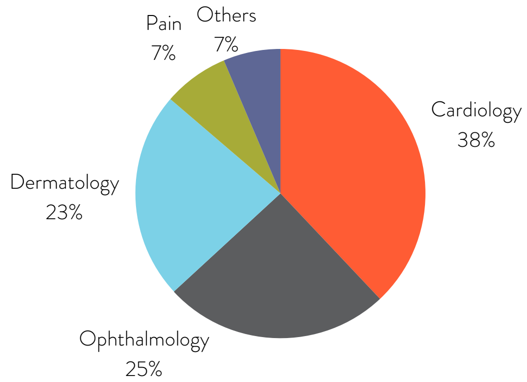
EPS projected to grow 26% for FY21-FY23 (vs. flat growth in previous five years)

FIG 2 – EPS GROWTH



Source: Company, BOBCAPS Research

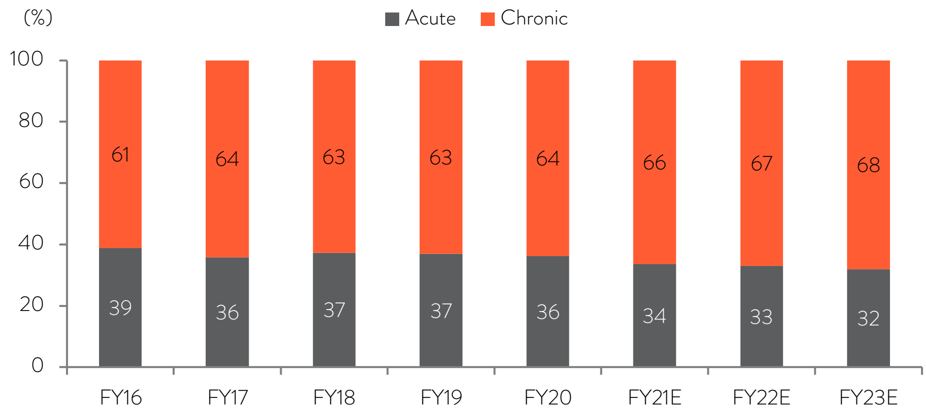
FIG 3 – INDIA FORMULATION: THERAPY MIX (FY20)



Source: Company, BOBCAPS Research

Favourable mix shift

FIG 4 – INDIA FORMULATION: CHRONIC AND ACUTE MIX

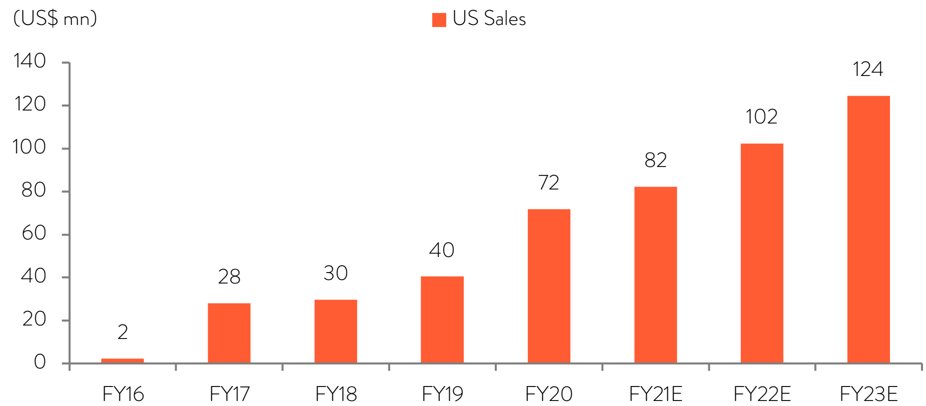


Source: Company, BOBCAPS Research

Expect +20% CAGR over FY20-FY23 led by >10 launches per year

Key H2 launches: Tamiflu Susp, Divalproex DR

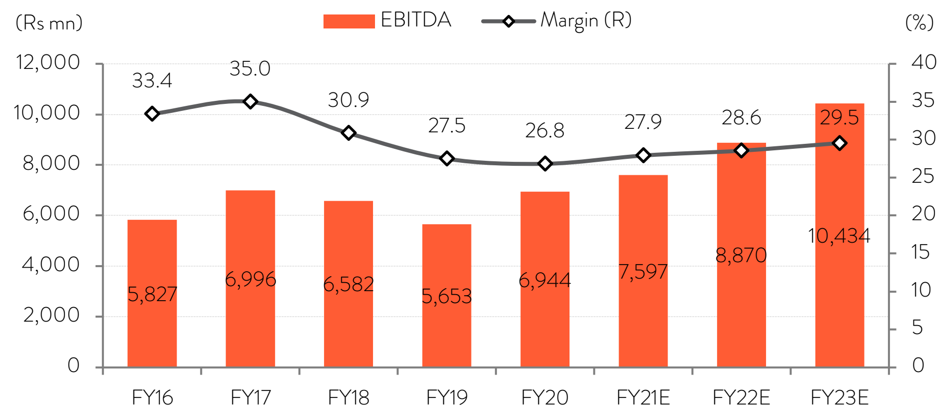
FIG 5 – US SALES TREND



Source: Company, BOBCAPS Research

Over 300bps margin expansion by FY23E, led by India chronic mix, operation efficiency and US operating leverage

FIG 6 – EBITDA AND MARGINS

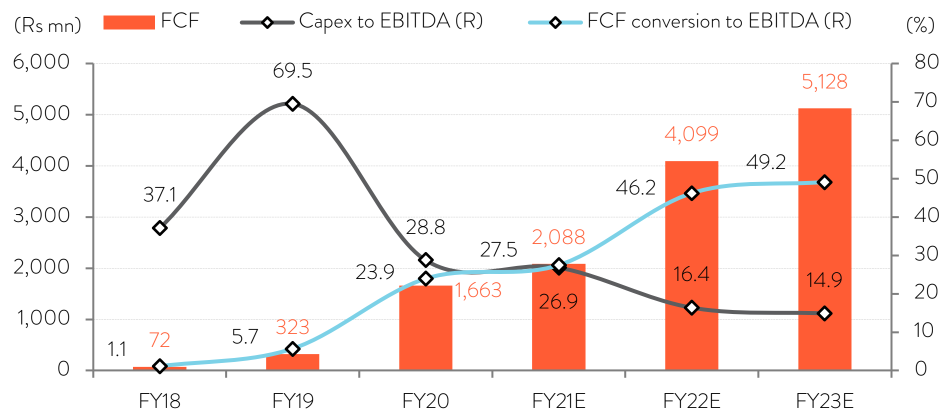


Source: Company, BOBCAPS Research

Capex tailwinds to boost FCF

Next capex cycle to start in FY25

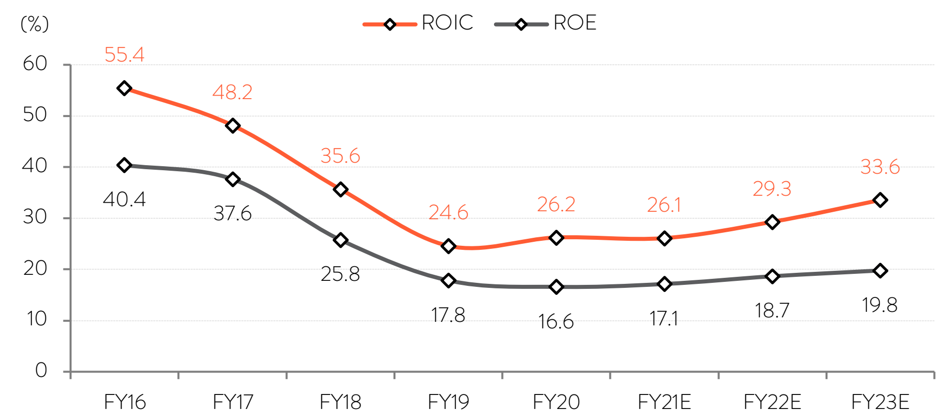
FIG 7 – FREE CASH GENERATION



Source: Company, BOBCAPS Research

At inflection point in the cycle

FIG 8 – RETURN RATIOS



Source: Company, BOBCAPS Research

Valuation methodology

AJP has a strong track record in terms of rational capital allocation, building a brand franchise, flawless cGMP compliance and stable returns ratios. We believe the branded generic franchise (India and EM) is strong and likely to remain resilient – this alongside operating leverage in the US business should drive an accelerated 25%+ EPS CAGR over FY21-FY23 (vs. flat growth for FY18-FY20).

In FY18, the company embarked on a major capex drive worth Rs 11bn towards augmenting formulation capacity, which is now nearing an end and should fuel a doubling of current sales, per management. We expect improved FCF momentum over the next 2-3 years based on healthy earnings growth and a normalised capex run-rate of Rs 1bn-1.25bn annually. ROIC levels are thus forecast to expand from 26% in FY20 to 34% by FY23.

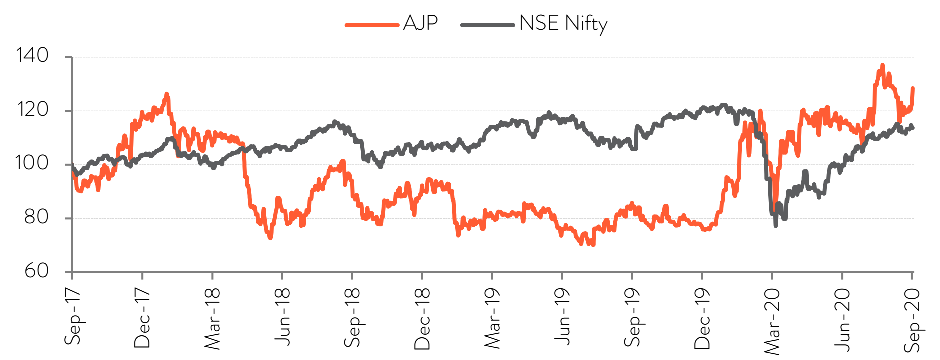
We increase our FY21-FY23 EPS estimates by 3-5% to factor in higher EBITDA margin assumptions for the US business and cost optimization in India business. At CMP, the stock is trading at 14x FY23E EBITDA (10% below the 10-year mean and 40% below the 10-year high) and 19x P/E which looks attractive in the context of ROIC improvement. We retain BUY with a revised Sep'21 target price of Rs 1,900 (from Rs 1,730), set at an unchanged 16x one-year forward EV/EBITDA multiple (24x implied P/E).

FIG 9 – REVISED ESTIMATES

(Rs bn)	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Sales	27.2	31.0	35.3	27.7	31.4	35.4	(1.7)	(1.0)	(0.1)
EBITDA	7.6	8.9	10.4	7.4	8.7	10.0	2.2	2.2	4.0
EBITDA margin (%)	27.9	28.6	29.5	26.9	27.7	28.4	106bps	92bps	118bps
EPS (Rs)	56	70	87	54	68	83	2.5	2.8	4.6

Source: Company, BOBCAPS Research

FIG 10 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Concentration and regulatory risk in India business:** AJP's domestic formulation business is concentrated around three key therapies – ophthalmology, cardiology and dermatology – which drive 90% of sales. Any adverse regulatory action here can slow down overall business momentum. Current portfolio under price control is at 13% of India sales vs. 16% for industry.
- **US execution:** We estimate that the US business will contribute a third of our EPS over the next three years. This is mainly dependent on two key units – Paithan (~70% of existing US sales) and Dahej (~30%, and a key future growth driver). Establishment inspection reports (EIR) for both units are in place (received in Aug'19). Thus, strong cGMP compliance is key.
- **Slower offtake in branded generic exports:** Currency devaluation and repatriation concerns will lead to slower growth in branded generics markets.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	**20,553**	**25,878**	**27,199**	**31,046**	**35,317**
EBITDA	5,653	6,944	7,597	8,870	10,434
Depreciation	720	957	1,104	1,181	1,264
EBIT	4,933	5,987	6,493	7,689	9,170
Net interest income/(expenses)	(12)	(119)	(52)	(78)	(78)
Other income/(expenses)	210	176	349	585	907
Exceptional items	0	0	0	0	0
EBT	5,132	6,044	6,789	8,196	9,999
Income taxes	1,263	1,962	1,901	2,049	2,400
Extraordinary items	0	595	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	**3,869**	**4,677**	**4,888**	**6,147**	**7,599**
Adjustments	0	595	0	0	0
Adjusted net profit	**3,869**	**4,082**	**4,888**	**6,147**	**7,599**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	2,252	3,622	2,981	3,402	3,870
Other current liabilities	944	1,831	1,360	1,552	1,766
Provisions	383	246	259	295	336
Debt funds	340	436	1,300	1,300	1,300
Other liabilities	0	0	0	0	0
Equity capital	175	175	175	175	175
Reserves & surplus	22,545	26,398	30,309	35,226	41,305
Shareholders' fund	22,721	26,573	30,484	35,401	41,481
Total liabilities and equities	**26,640**	**32,708**	**36,383**	**41,951**	**48,753**
Cash and cash eq.	1,004	2,049	4,355	7,605	11,843
Accounts receivables	4,594	7,753	6,707	7,655	8,708
Inventories	4,357	4,956	5,589	6,379	7,257
Other current assets	1,510	1,211	2,176	2,484	2,825
Investments	776	794	794	794	794
Net fixed assets	11,719	14,509	14,763	15,034	15,324
CWIP	2,613	1,318	2,000	2,000	2,000
Intangible assets	67	117	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	**26,640**	**32,707**	**36,383**	**41,951**	**48,753**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	4,589	5,634	5,993	7,328	8,863
Interest expenses	12	119	52	78	78
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(186)	(1,339)	(1,651)	(1,396)	(1,550)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	**4,414**	**4,415**	**4,394**	**6,010**	**7,391**
Capital expenditures	(1,930)	(3,294)	(1,358)	(1,453)	(1,555)
Change in investments	1,123	(18)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	**(807)**	**(3,313)**	**(1,358)**	**(1,453)**	**(1,555)**
Equities issued/Others	(2)	0	0	0	0
Debt raised/repaid	330	96	865	0	0
Interest expenses	(12)	(119)	(52)	(78)	(78)
Dividends paid	(795)	(816)	(978)	(1,229)	(1,520)
Other financing cash flows	(3,055)	783	(565)	0	0
Cash flow from financing	**(3,533)**	**(57)**	**(730)**	**(1,307)**	**(1,598)**
Changes in cash and cash eq.	**74**	**1,045**	**2,306**	**3,250**	**4,239**
Closing cash and cash eq.	**1,004**	**2,049**	**4,355**	**7,605**	**11,843**

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	44.1	53.3	55.7	70.1	86.6
Adjusted EPS	44.1	46.6	55.7	70.1	86.6
Dividend per share	9.0	9.3	11.1	14.0	17.3
Book value per share	259.1	303.0	347.6	403.7	473.0

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	6.8	5.4	5.2	4.5	3.9
EV/EBITDA	24.9	20.3	18.5	15.7	13.1
Adjusted P/E	36.6	34.7	28.9	23.0	18.6
P/BV	6.2	5.3	4.6	4.0	3.4

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	75.4	67.5	72.0	75.0	76.0
Interest burden (PBT/EBIT)	104.0	101.0	104.6	106.6	109.0
EBIT margin (EBIT/Revenue)	24.0	23.1	23.9	24.8	26.0
Asset turnover (Revenue/Avg TA)	23.5	25.8	23.1	22.7	22.2
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	17.8	16.6	17.1	18.7	19.8

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	(3.6)	25.9	5.1	14.1	13.8
EBITDA	(14.1)	22.8	9.4	16.8	17.6
Adjusted EPS	(17.4)	5.5	19.7	25.7	23.6
Profitability & Return ratios (%)					
EBITDA margin	27.5	26.8	27.9	28.6	29.5
EBIT margin	24.0	23.1	23.9	24.8	26.0
Adjusted profit margin	18.8	15.8	18.0	19.8	21.5
Adjusted ROAE	17.8	16.6	17.1	18.7	19.8
ROCE	23.5	24.6	23.3	24.2	25.4
Working capital days (days)					
Receivables	82	109	90	90	90
Inventory	77	70	75	75	75
Payables	40	51	40	40	40
Ratios (x)					
Gross asset turnover	1.3	1.3	1.3	1.4	1.5
Current ratio	3.2	2.8	4.1	4.6	5.1
Net interest coverage ratio	425.3	50.3	124.7	98.6	117.6
Adjusted debt/equity	0.0	(0.1)	(0.1)	(0.2)	(0.3)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

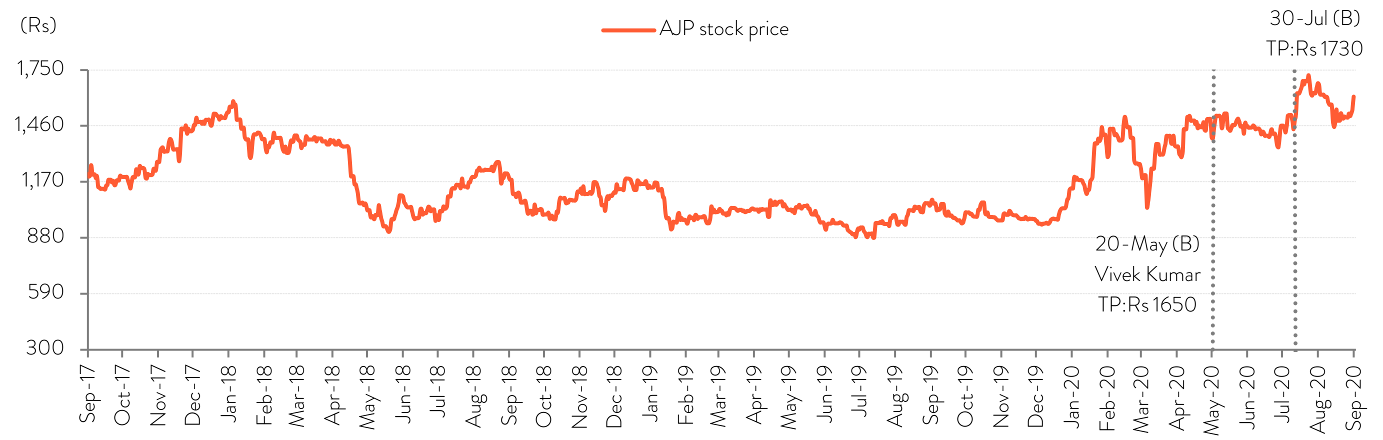
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): AJANTA PHARMA (AJP IN)



B – Buy, A – Add, R – Reduce, S – Sell

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