

BUY

TP: Rs 1,500 | ▲ 17%

AJANTA PHARMA

| Pharmaceuticals

| 29 July 2022

Margin stress continues despite strong revenue growth

- Q1 revenue growth robust at 27% YoY (13% ahead of consensus), supported by a low base in Asia/Africa and momentum in India
- EBITDA margin down 610bps YoY to 23.3% owing to tight US pricing, RM inflation and inventory write-offs
- TP revised to Rs 1,500 (vs. Rs 2,050) as we cut FY23/FY24 EBITDA by 10%/8% and reset to 12x FY24E EV/EBITDA (vs. 15x); retain BUY

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Domestic business on strong footing: Momentum continued in AJP's domestic formulations business which grew 22% YoY to Rs 2.8bn in Q1FY23, backed by new product launches (seven in Q1), market share gains and price increases. Trade generics (~12% share in India business) grew 22% YoY to Rs 330mn. Africa/Asia business also posted strong growth of 38%/46% YoY on a low pandemic-hit base. Management expects slight moderation in these geographies going forward.

US business hovering at ~US\$ 23mn: US business remained slow in Q1, growing at a modest 1.5% QoQ to US\$ 23mn. Management indicated that the intensity of price erosion has subsided and expects to see growth going forward given 10-12 ANDA filings in FY23. The company has guided for ~5% growth in the existing US business in FY23 to be further supported by tailwinds from INR depreciation against the USD.

Targeting 26-27% EBITDA margins: AJP's Q1 gross margin contracted 650bps YoY to 70.5% and EBITDA margin fell 610bps YoY to 23.3% due to US pricing pressure, RM inflation and inventory write-offs. Management is looking to improve the FY23 operating margin by 300bps to 26-27% aided by easing price erosion intensity (expect to normalize around 5-6%) as well as significant launches such as Chantix and Vimovo in the US, along with mid-teens' growth in India.

Retain BUY; TP cut to Rs 1,500: In light of the continued fall in EBITDA margin to 23% in Q1FY23 vs. an average of ~30% until recently, we lower our margin estimates by 250-300bps to 25-26% for FY23-FY24. This results in an 8-10% cut in EBITDA. We also pare our target EV/EBITDA multiple to 12x from 15x (20% discount to last 5-year average multiple), translating to a reduced TP of Rs 1,500 (vs. Rs 2,050). We maintain BUY as we believe margins have bottomed out and sustained growth in the domestic market alongside planned US launches would fuel stock upsides.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	AJP IN/Rs 1,279
Market cap	US\$ 2.1bn
Free float	31%
3M ADV	US\$ 2.0mn
52wk high/low	Rs 2,390/Rs 1,165
Promoter/FPI/DII	70%/9%/12%

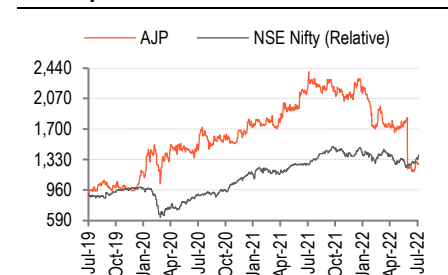
Source: NSE | Price as of 29 Jul 2022

Key financials

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	33,410	37,465	40,741
EBITDA (Rs mn)	9,293	9,379	10,607
Adj. net profit (Rs mn)	7,127	6,442	7,373
Adj. EPS (Rs)	83.0	50.1	57.4
Consensus EPS (Rs)	83.0	58.0	67.2
Adj. ROAE (%)	22.5	18.1	17.9
Adj. P/E (x)	15.4	25.5	22.3
EV/EBITDA (x)	17.5	17.3	15.2
Adj. EPS growth (%)	7.2	(39.6)	14.4

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
Net Sales	9,509	7,480	27.1	8,703	9.3	33,410	28,897	15.6
EBITDA	2,218	2,202	0.7	2,067	7.3	9,293	9,986	(6.9)
Depreciation	318	309	2.9	312	2.0	1,253	1,161	-
EBIT	1,900	1,893	0.3	1,755	8.2	8,040	8,825	-
Interest	9	15	(41.7)	73	(88.0)	102	83	-
Other Income	328	326	0.4	295	11.1	1,157	260	-
PBT	2,219	2,205	0.6	1,977	12.2	9,095	9,002	1.0
Less: Taxation	472	467	1.2	465	1.7	1,968	2,463	-
Less: Minority Interest	-	-	-	-	-	0	0	-
Recurring PAT	1,746	1,738	0.5	1,512	15.5	7,127	6,539	9.0
Exceptional items	0	0		0		0	0	-
Reported PAT	1,746	1,738	0.5	1,512	15.5	7,127	6,539	9.0
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	70.5	77.1	(654)	72.5	(199)	75.1	77.7	(259)
EBITDA Margin	23.3	29.4	(612)	23.7	(43)	27.8	34.6	(674)
Tax / PBT	21.3	21.2	-	23.5	-	21.6	27.4	-
NPM	18.4	23.2	(487)	17.4	99	21.3	22.6	-
EPS (Rs)	13.6	20.0	-	17.6	-	81	75	9.0

Source: Company, BOBCAPS Research

Fig 2 – Segmental performance

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
Domestic Formulation	2,790	2,290	21.8	2,450	13.9	9,780	8,140	20.1
Exports Formulation	6,640	5,100	30.2	6,160	7.8	23,000	20,294	13.3
Africa	2,450	1,770	38.4	1,860	31.7	7,910	6,810	16.2
Asia	2,400	1,650	45.5	2,620	(8.4)	8,120	7,114	14.1
US	1,790	1,680	6.5	1,680	6.5	6,960	6,370	9.3
Other op income	79	90	(11.8)	93	(14.6)	630	478	31.7
Revenues	9,509	7,480	27.1	8,703	9.3	33,410	28,912	15.6
USDINR	79	74	7.2	75	5.0	75	74	0.7
US revenue (US\$ mn)	23	23	(0.6)	22	1.5	93	86	8.5

Source: Company, BOBCAPS Research

Earnings call takeaways

- **Margins:** AJP's gross margin contracted 650bps YoY to 70.5% in Q1FY23 on account of inventory write-off (~200bps impact), price erosion in the US (100bps) and raw material cost inflation (100bps). Management has guided for an EBITDA margin of 26-27% in FY23.
- **India:** India business grew 22% YoY with volumes contributing 6% of the growth, price hikes 7% and new launches the balance. AJP launched seven new products in Q1FY23, of which two were first to market. Management expects mid-teens' growth in the domestic business in FY23.
- **NLEM:** The impact of price increases in the NLEM (National List of Essential Medicines) portfolio started to reflect by end-Q1. About 12% of AJP's domestic revenue comes from the NLEM portfolio.
- **Domestic trade generics:** The company is focusing more on chronic therapies in this trade generics in order to differentiate from competitors. Growth momentum is likely to continue in coming quarters.
- **US:** AJP has not witnessed any sequential increase in US price erosion this quarter. It filed one product in Q1FY23 and has another 10-12 ANDAs planned for FY23. Management expects US revenue to grow 4-5% in FY23 before new launches kick in from FY24.
- **Africa:** The company expects mid-teens' growth in Africa branded business. Africa institutional business is very unpredictable at the moment. MR additions in this market increased by 8% YoY.
- **Inorganic opportunities:** AJP is open to inorganic opportunities and is scouting for acquisitions in the domestic market.
- **R&D:** R&D expense was at Rs 540mn (5.7% of sales) in Q1FY23.
- **ETR:** The effective tax rate for FY23 is guided at ~21% and 20-21% next year.
- **Capex:** Capex guidance for FY23 has been maintained at Rs 2bn. Q1 spend was Rs 430mn (4.5% of revenue).

Valuation methodology

We reduce our FY23/FY24 EBITDA estimates by 10%/8% in light of margin pressure arising from raw material cost inflation, US price erosion and expenses retracing to pre-pandemic levels. Given these headwinds, we also lower our target FY24E EV/EBITDA multiple to 12x (vs. 15x), translating to a reduced TP of Rs 1,500 (vs. Rs 2,050).

AJP is currently trading at 16x on FY24E EV/EBITDA, in-line with its 5-year average multiple. We maintain BUY as we believe margins have bottomed out and sustained growth in the domestic market alongside planned US launches would fuel stock upsides.

Fig 3 – Revised estimates

(Rs bn)	New			Old		Change (%)	
	FY22A	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	33,410	37,465	40,741	37,073	40,328	1.1	1.0
EBITDA	9,293	9,379	10,607	10,393	11,508	(9.8)	(7.8)
EBITDA Margin (%)	27.8	25.0	26.0	28.0	28.5	(300bps)	(250bps)
EPS (Rs)	55.4	50	57	56	63	(10.8)	(9.0)

Source: BOBCAPS Research

Fig 4 – Key assumptions

(Rs bn)	FY22A	FY23E	FY24E
India	9.8	10.9	12.1
Africa	7.9	9.0	9.8
Asia	8.1	8.9	9.8
US	7.0	7.9	8.3
Others	0.0	0.0	0.0
OOI	0.6	0.6	0.6

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY22-24E (%)	EV/EBITDA (x)		ROCE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Ajanta Pharma	AJP IN	BUY	1,500	6.8	11.3	10.0	21.8	21.9	12.0
Alkem Labs	ALKEM IN	BUY	3,400	13.8	17.6	14.5	18.1	20.4	15.0
Alembic Pharma	ALPM IN	HOLD	770	14.6	9.4	8.3	12.4	16.0	11.0

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- **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. The current portfolio under price control contributes 12% of its India sales.
- **US price erosion:** High competitive intensity may adversely impact US business.
- **Slower offtake in branded generic exports:** Currency devaluation and repatriation concerns could lead to slower growth in branded generics markets.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.1	1,279	1,500	BUY
Alembic Pharma	ALPM IN	1.7	702	770	HOLD
Alkem Labs	ALKEM IN	4.9	3,225	3,400	BUY
Aurobindo Pharma	ARBP IN	4.0	547	680	BUY
Cipla	CIPLA IN	9.9	977	1,100	BUY
Divi's Labs	DIVI IN	12.8	3,832	4,250	HOLD
Dr Reddy's Labs	DRRD IN	8.6	4,090	4,450	HOLD
Eris Lifesciences	ERIS IN	1.2	678	970	BUY
Glenmark Life Sciences	GLS IN	0.7	464	620	BUY
Laurus Labs	LAURUS IN	3.5	523	645	BUY
Lupin	LPC IN	3.7	644	600	SELL
Sun Pharma	SUNP IN	28.5	943	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 29 Jul 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Total revenue	25,878	28,897	33,410	37,465	40,741
EBITDA	6,833	10,192	9,293	9,379	10,607
Depreciation	957	1,161	1,253	1,292	1,388
EBIT	5,876	9,031	8,040	8,088	9,219
Net interest inc./(exp.)	(119)	(83)	(102)	(15)	(15)
Other inc./(exp.)	921	251	1,157	294	497
Exceptional items	0	0	0	0	0
EBT	6,678	9,199	9,095	8,366	9,701
Income taxes	1,962	2,463	1,968	1,924	2,328
Extraordinary items	39	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	4,756	6,736	7,127	6,442	7,373
Adjustments	39	0	0	0	0
Adjusted net profit	4,716	6,736	7,127	6,442	7,373

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Accounts payables	3,622	3,739	3,272	4,106	4,465
Other current liabilities	1,831	2,677	3,070	1,873	2,037
Provisions	246	296	301	338	367
Debt funds	436	198	250	250	250
Other liabilities	0	0	0	0	0
Equity capital	175	174	172	257	257
Reserves & surplus	26,398	30,203	32,935	38,003	43,901
Shareholders' fund	26,573	30,377	33,107	38,260	44,159
Total liab. and equities	32,708	37,286	40,000	44,828	51,278
Cash and cash eq.	2,049	2,096	2,118	4,660	9,166
Accounts receivables	7,753	7,384	10,198	9,238	10,046
Inventories	4,956	7,665	7,911	8,725	9,488
Other current assets	1,211	1,891	1,656	2,997	3,259
Investments	794	1,846	1,554	1,554	1,554
Net fixed assets	14,509	15,214	14,946	15,654	15,766
CWIP	1,318	1,082	1,529	2,000	2,000
Intangible assets	117	108	90	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	32,707	37,286	40,000	44,828	51,278

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Cash flow from operations	4,414	5,971	5,590	6,227	7,496
Capital expenditures	(3,294)	(1,550)	(1,540)	(2,000)	(1,500)
Change in investments	(18)	(1,051)	292	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(3,313)	(2,601)	(1,248)	(2,000)	(1,500)
Equities issued/Others	0	(2)	(2)	85	0
Debt raised/repaid	96	(238)	53	0	0
Interest expenses	(119)	(83)	(102)	(15)	(15)
Dividends paid	(943)	(1,347)	(1,425)	(1,288)	(1,475)
Other financing cash flows	910	(1,654)	(2,843)	(467)	0
Cash flow from financing	(56)	(3,323)	(4,320)	(1,685)	(1,490)
Chg in cash & cash eq.	1,045	47	22	2,542	4,506
Closing cash & cash eq.	2,049	2,096	2,118	4,660	9,166

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22P	FY23E	FY24E
Reported EPS	53.3	76.8	83.0	50.1	57.4
Adjusted EPS	53.8	77.5	83.0	50.1	57.4
Dividend per share	10.8	15.5	16.6	10.0	11.5
Book value per share	303.0	346.4	377.5	436.3	503.5

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22P	FY23E	FY24E
EV/Sales	6.3	5.6	4.9	4.3	4.0
EV/EBITDA	23.9	16.0	17.5	17.3	15.2
Adjusted P/E	23.8	16.5	15.4	25.5	22.3
P/BV	4.2	3.7	3.4	2.9	2.5

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22P	FY23E	FY24E
Tax burden (Net profit/PBT)	70.6	73.2	78.4	77.0	76.0
Interest burden (PBT/EBIT)	113.6	101.9	113.1	103.4	105.2
EBIT margin (EBIT/Revenue)	22.7	31.3	24.1	21.6	22.6
Asset turnover (Rev./Avg TA)	25.8	25.1	26.1	26.1	24.6
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	19.1	23.7	22.5	18.1	17.9

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22P	FY23E	FY24E
YoY growth (%)					
Revenue	25.9	11.7	15.6	12.1	8.7
EBITDA	20.9	49.1	(8.8)	0.9	13.1
Adjusted EPS	21.9	44.0	7.2	(39.6)	14.4
Profitability & Return ratios (%)					
EBITDA margin	26.4	35.3	27.8	25.0	26.0
EBIT margin	22.7	31.3	24.1	21.6	22.6
Adjusted profit margin	18.2	23.3	21.3	17.2	18.1
Adjusted ROAE	19.1	23.7	22.5	18.1	17.9
ROCE	27.2	32.2	28.8	23.3	23.4
Working capital days (days)					
Receivables	109	93	111	90	90
Inventory	70	97	86	85	85
Payables	51	47	36	40	40
Ratios (x)					
Gross asset turnover	1.3	1.4	1.5	1.5	1.6
Current ratio	2.8	2.8	3.3	4.1	4.7
Net interest coverage ratio	49.4	109.2	78.8	538.5	613.9
Adjusted debt/equity	(0.1)	(0.1)	(0.1)	(0.1)	(0.2)

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

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

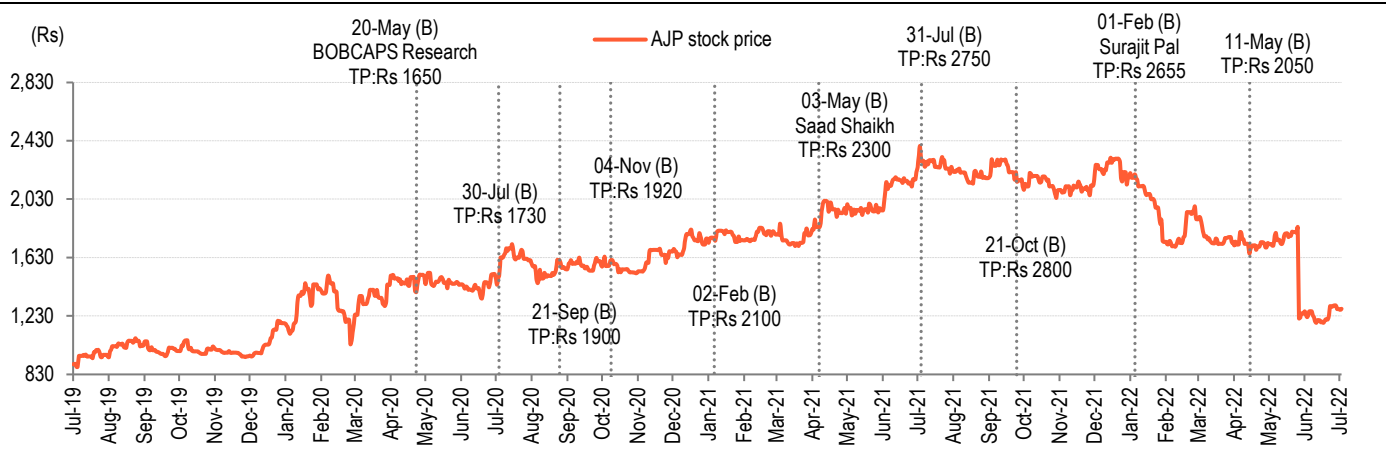
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): AJANTA PHARMA (AJP IN)



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

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