

BUY

TP: Rs 2,655 | ▲ 21%

AJANTA PHARMA

| Pharmaceuticals

| 01 February 2022

Strong revenue growth but margins contract

- Q3 revenue up 12% YoY spurred by branded formulations business in India and Africa; US sales down 14% QoQ to US\$ 22mn
- US price erosion, rising RM and SG&A expense reduced EBITDA margin by 370bps YoY, marginally offset by higher branded formulation sales
- We retain earnings estimates but cut our EV/EBITDA multiple to 17x (vs. 19x). On rollover, our TP moves to Rs 2,655 (vs. Rs 2,800); retain BUY

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Growth driven by branded formulation business: AJP's Q3FY22 performance was largely in line with consensus estimates. Revenue growth of 12% YoY (-5% QoQ) to Rs 8.4bn was 1% higher than consensus. Growth was primarily supported by branded formulations in India (+16% YoY) and Africa (+87% YoY). Supernormal growth of branded generics in the US benefitted from the lower base in the continent. Asia sales declined 1% YoY due to supply chain disruptions with unpredictable lockdowns in key economies.

Domestic growth momentum continues: AJP posted healthy domestic growth, outperformed the market in key therapies. It grew 12% YoY in cardiology (vs. segment growth of 11%), 29% in ophthalmology (vs. 22%), 18% in dermatology (vs. 12%) and 34% in pain management (vs. 20%).

US business declines: US revenue decreased 14% QoQ to US\$ 22mn due to severe pricing pressure and a lack of new launches. The company plans to file around seven ANDAs in Q4 in order to regain launch momentum.

Rising costs hit EBITDA margin; branded sales support gross margin: EBITDA margin for Q3 dropped 370bps YoY to 28.6% because of rising input costs and higher SG&A expenses. Despite higher price erosion in the US, the company was able to sustain its gross margin at 77.4% (+370bps QoQ) due to the higher branded business contribution from India and Africa.

Reiterate BUY: We find current valuations attractive at 15x FY24E EV/EBITDA as AJP's stable brand franchise (India/EM), US operating leverage, lower tax burden and capex moderation are likely to drive a brisk 15% EPS CAGR over FY21-FY24. Further, improving FCF, 38%+ ROIC beyond FY24E and a steady pace of launches (21 brands launched in India in FY21) should support upsides in key fundamentals. We broadly retain our earnings estimates but are wary of margin pressure (9MFY22 EBITDA margin contracted 540bps) and hence trim our EV/EBITDA multiple to 17x (vs. 19x). Rolling over to FY24 valuations, our TP reduces to Rs 2,655 (vs. Rs 2,800). We retain BUY.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	AJP IN/Rs 2,201
Market cap	US\$ 2.6bn
Free float	31%
3M ADV	US\$ 2.2mn
52wk high/low	Rs 2,435/Rs 1,660
Promoter/FPI/DII	70%/9%/12%

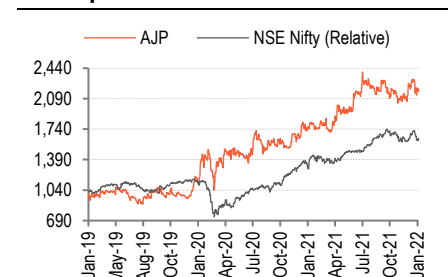
Source: NSE | Price as of 31 Jan 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	28,897	33,007	37,456
EBITDA (Rs mn)	9,990	10,108	11,834
Adj. net profit (Rs mn)	6,534	7,659	8,852
Adj. EPS (Rs)	74.5	87.3	100.9
Consensus EPS (Rs)	74.5	83.2	99.5
Adj. ROAE (%)	22.9	22.9	22.1
Adj. P/E (x)	29.5	25.2	21.8
EV/EBITDA (x)	19.0	18.8	15.9
Adj. EPS growth (%)	38.5	17.2	15.6

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Net Sales	8,379	7,487	11.9	8,848	(5.3)	24,707	21,329	15.8
EBITDA	2,396	2,417	(0.9)	2,628	(8.8)	7,226	7,392	(2.2)
Depreciation	317	291	-	315	-	941	855	-
EBIT	2,079	2,125	(2.2)	2,313	(10.1)	6,285	6,537	(3.9)
Interest	10	26	-	4	-	29	57	-
Other Income	240	55	-	295	-	862	234	-
PBT	2,309	2,155	7.2	2,604	(11.3)	7,118	6,714	6.0
Less: Taxation	392	388	-	645	-	1,503	1,768	-
Less: Minority Interest	-	-	-	-	-	0	0	-
Recurring PAT	1,918	1,766	8.6	1,959	(2.1)	5,615	4,947	13.5
Exceptional items	0	0	-	0	-	0	0	-
Reported PAT	1,918	1,766	8.6	1,959	(2.1)	5,615	4,947	13.5
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	77.4	77.5	(3)	73.8	368	76.0	77.6	(163)
EBITDA Margin	28.6	32.3	(369)	29.7	(111)	29.2	34.7	(541)
Tax / PBT	17.0	18.0	-	24.8	-	21.1	26.3	-
NPM	22.9	23.6	(70)	22.1	74	22.7	23.2	-
EPS (Rs)	22.1	20.1	-	22.5	-	65	56	-

Source: Company, BOBCAPS Research

Fig 2 – Segment mix

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Domestic Formulation	2,560	2,200	16.4	2,480	3.2	7,330	5,960	23.0
Exports Formulation	5,630	5,230	7.6	6,110	(7.9)	16,840	15,034	12.0
Africa	2,030	1,660	22.3	2,250	(9.8)	6,050	5,020	20.5
Asia	1,940	1,960	(1.0)	1,910	1.6	5,500	5,374	2.3
US	1,660	1,610	3.1	1,940	(14.4)	5,280	4,640	13.8
Other op Income	189	57	231.8	258	(26.7)	537	350	53.4
Revenues	8,379	7,487	11.9	8,848	(5.3)	24,707	21,344	15.8
USDINR	74	75	(1.2)	74	0.0	74	74	0
US revenue (US\$ mn)	22	21	4.4	26	(14.4)	71	62	14.4

Source: Company, BOBCAPS Research

Earnings call highlights

- **EM growth:** Branded generic sales in emerging markets (Asia and Africa) contributed 41% revenue share and grew 26% YoY in Q3FY22, mainly led by Africa sales. AJP's branded Africa sales surged 87% YoY due to the benefits of a lower base. Asia declined only 1% YoY due to supply chain disruptions stemming from unpredictable lockdowns in key economies.
- **US generics:** US generics contributed 22% of revenue and grew 3% YoY to Rs 1.7bn in Q3. AJP filed three new ANDAs, received one approval and launched three products. Management has guided for 10-12 ANDA filings a year.
- **Africa institutional tender business:** With 6% revenue contribution, AJP's Africa tender business declined by 53% YoY. Management has guided for normal growth in FY22. For 9MFY22, Africa institutional business declined by 18% YoY.
- **India formulations:** India formulations formed 30% of revenue and grew 16% YoY in Q3 (+23% in 9MFY22). The launch of 16 new products (including 4 first-to-market), market share gains and price hikes boosted growth. Per management, overhead costs have retraced to pre-Covid levels and hence are unlikely to increase much hereon.
- **R&D expense:** At 6% of sales, R&D expense is back to pre-Covid levels with clinical trials returning to normal.
- **Capex:** AJP incurred capex of Rs 1.15bn in 9MFY22 and maintained its Rs 2bn guidance for FY22.

Valuation methodology

AJP has a strong track record in terms of rational capital allocation, building a brand franchise, better cGMP compliance and stable returns ratios. We believe the branded generic franchise (India and EM) is robust and likely to remain resilient – this alongside operating leverage in the US business should drive a 15%+ EPS CAGR over FY21-FY24 (vs. flat growth for FY18-FY20).

In FY18, the company embarked on a major capex drive worth Rs 11bn towards augmenting formulations capacity, which is now nearing the completion and benefits in augmenting current core sales, as guided by management. We expect improved FCF momentum over the next 2-3 years based on healthy earnings growth and a normalised capex of Rs 1bn-1.2bn annually. ROIC is thus forecast to expand north of 38% beyond FY24.

Post the Q3FY22 results, we retain our earnings estimates but are wary of margin pressure (9MFY22 EBITDA margin contracted 540bps) and hence lower our EV/EBITDA multiple to 17x (from 19x) – reducing the valuation premium to ~5% above the peer group. With roll forward to FY24 valuations, our TP reduces to Rs 2,655 (from Rs 2,800). Maintain BUY.

Fig 3 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Sales	33.0	37.5	42.4	33.0	37.5	42.4	(0.0)	(0.0)	(0.0)
EBITDA	10.1	11.8	13.2	10.1	11.8	13.2	0.0	(0.0)	(0.0)
EBITDA margin (%)	30.6	31.6	31.1	30.6	31.6	31.1	0bps	(0bps)	(0bps)
EPS (Rs)	88.1	101.8	113.7	84.1	101.5	114.3	4.7	0.3	(0.6)

Source: BOBCAPS Research

Fig 4 – Key assumptions

Revenue (Rs bn)	FY21	FY22E	FY23E	FY24E
India Formulation	8.1	9.2	10.4	11.8
Africa	6.7	7.1	7.6	8.1
Asia	7.2	8.3	9.4	10.6
US	6.4	7.6	9.2	11.0
Others	0.0	0.0	0.0	0.0
OOI	0.4	0.7	0.8	0.9

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY21-24E (%)	EPS (Rs)		ROE (%)		Target EV/EBITDA (x)
					FY22E	FY23E	FY22E	FY23E	
Ajanta Pharma	AJP IN	BUY	2,655	9.7	15.7	14.1	22.1	21.0	17
Alkem Labs	ALKEM IN	HOLD	4,250	7.0	16.4	14.3	23.3	22.9	19
Alembic Pharma	ALPM	BUY	980	3.5	9.6	8.4	14.1	16.2	13
Ipca Labs*	IPCA IN	NR	-	10.1	14.6	12.4	20.3	19.7	-
Aggregate	-	-	-	-	14.1	12.3	20.0	19.9	16

Source: BOBCAPS Research, *Bloomberg consensus estimates

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. The current portfolio under price control contributes 15% of its India sales.
- 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 (~90% of existing US sales) and Dahej (future growth driver). Establishment inspection reports (EIR) for both units are in place (last inspected in Jul-Aug'19). Thus, better cGMP compliance is key.
- 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	2.6	2,201	2,655	BUY
Alembic Pharma	ALPM IN	2.0	757	980	BUY
Alkem Labs	ALKEM IN	5.7	3,539	4,250	HOLD
Aurobindo Pharma	ARBP IN	5.0	634	886	BUY
Cipla	CIPLA IN	10.2	945	1,160	BUY
Divi's Labs	DIVI IN	14.4	4,036	5,540	HOLD
Dr Reddy's Labs	DRRD IN	9.6	4,303	4,700	HOLD
Eris Lifesciences	ERIS IN	1.3	699	890	BUY
Laurus Labs	LAURUS IN	3.6	503	570	HOLD
Lupin	LPC IN	5.5	908	1,045	HOLD
Sun Pharma	SUNP IN	26.8	835	1,045	BUY

Source: BOBCAPS Research, NSE | Price as of 31 Jan 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	25,878	28,897	33,007	37,456	42,406
EBITDA	6,833	9,990	10,108	11,834	13,187
Depreciation	957	1,161	1,317	1,303	1,386
EBIT	5,876	8,829	8,792	10,530	11,801
Net interest inc./(exp.)	(119)	(83)	(49)	(12)	(12)
Other inc./(exp.)	921	251	1,078	830	1,329
Exceptional items	0	0	0	0	0
EBT	6,678	8,997	9,820	11,348	13,118
Income taxes	1,962	2,463	2,160	2,497	3,148
Extraordinary items	39	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	4,756	6,534	7,659	8,852	9,970
Adjustments	39	0	0	0	0
Adjusted net profit	4,716	6,534	7,659	8,852	9,970

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	3,622	3,739	3,617	4,105	4,647
Other current liabilities	1,831	2,677	1,650	1,873	2,120
Provisions	246	296	339	384	435
Debt funds	436	198	198	198	198
Other liabilities	0	0	0	0	0
Equity capital	175	174	174	174	174
Reserves & surplus	26,398	30,203	36,331	43,412	51,405
Shareholders' fund	26,573	30,377	36,505	43,586	51,579
Total liab. and equities	32,708	37,286	42,308	50,145	58,979
Cash and cash eq.	2,049	2,096	5,004	10,277	16,363
Accounts receivables	7,753	7,384	8,139	9,236	10,456
Inventories	4,956	7,665	6,782	7,696	8,714
Other current assets	1,211	1,891	2,641	2,996	3,392
Investments	794	1,846	1,846	1,846	1,846
Net fixed assets	14,509	15,214	15,897	16,094	16,208
CWIP	1,318	1,082	2,000	2,000	2,000
Intangible assets	117	108	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	32,707	37,286	42,308	50,145	58,979

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	4,414	5,770	7,299	8,556	9,574
Capital expenditures	(3,294)	(1,550)	(2,000)	(1,500)	(1,500)
Change in investments	(18)	(1,051)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(3,313)	(2,601)	(2,000)	(1,500)	(1,500)
Equities issued/Others	0	(2)	0	0	0
Debt raised/repaid	96	(238)	0	0	0
Interest expenses	(119)	(83)	(49)	(12)	(12)
Dividends paid	(943)	(1,307)	(1,532)	(1,770)	(1,977)
Other financing cash flows	910	(1,493)	(810)	0	0
Cash flow from financing	(56)	(3,122)	(2,392)	(1,782)	(1,989)
Chg in cash & cash eq.	1,045	47	2,908	5,273	6,086
Closing cash & cash eq.	2,049	2,096	5,004	10,277	16,363

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	53.3	74.5	87.3	100.9	113.7
Adjusted EPS	53.8	74.5	87.3	100.9	113.7
Dividend per share	10.8	15.0	17.6	20.4	22.7
Book value per share	303.0	346.4	416.2	497.0	588.1

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	7.4	6.6	5.7	5.0	4.3
EV/EBITDA	27.9	19.0	18.8	15.9	13.9
Adjusted P/E	40.9	29.5	25.2	21.8	19.4
P/BV	7.3	6.4	5.3	4.4	3.7

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	70.6	72.6	78.0	78.0	76.0
Interest burden (PBT/EBIT)	113.6	101.9	111.7	107.8	111.2
EBIT margin (EBIT/Revenue)	22.7	30.6	26.6	28.1	27.8
Asset turnover (Rev./Avg TA)	25.8	25.1	24.5	23.3	22.2
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	19.1	22.9	22.9	22.1	21.0

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	25.9	11.7	14.2	13.5	13.2
EBITDA	20.9	46.2	1.2	17.1	11.4
Adjusted EPS	21.9	38.5	17.2	15.6	12.6
Profitability & Return ratios (%)					
EBITDA margin	26.4	34.6	30.6	31.6	31.1
EBIT margin	22.7	30.6	26.6	28.1	27.8
Adjusted profit margin	18.2	22.6	23.2	23.6	23.5
Adjusted ROAE	19.1	22.9	22.9	22.1	21.0
ROCE	27.2	31.5	29.3	28.2	27.5
Working capital days (days)					
Receivables	109	93	90	90	90
Inventory	70	97	75	75	75
Payables	51	47	40	40	40
Ratios (x)					
Gross asset turnover	1.3	1.4	1.4	1.5	1.6
Current ratio	2.8	2.8	4.0	4.7	5.4
Net interest coverage ratio	49.4	106.8	177.9	887.7	994.8
Adjusted debt/equity	(0.1)	(0.1)	(0.1)	(0.2)	(0.3)

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

Disclaimer

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

BUY – Expected return >+15%

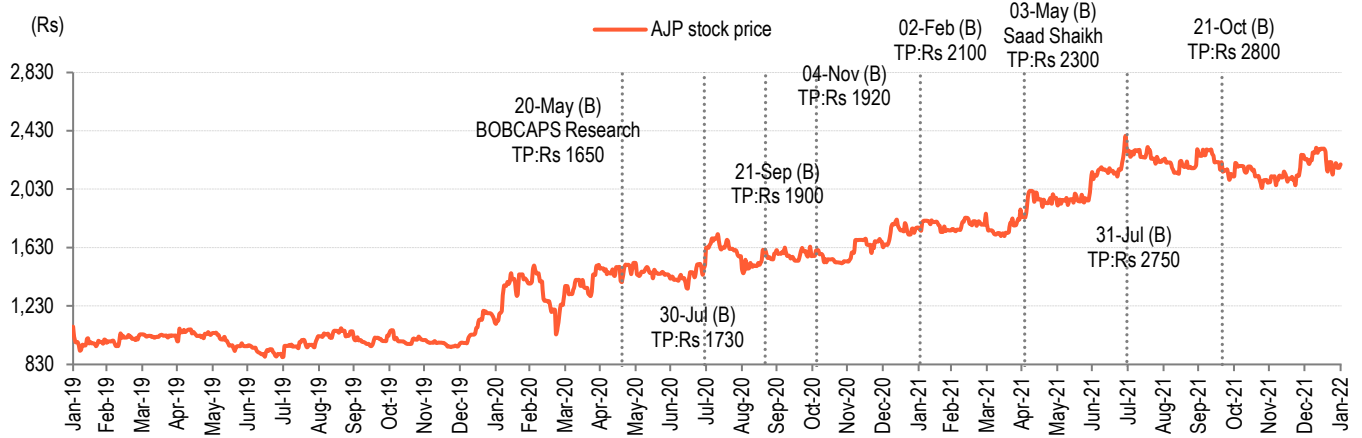
HOLD – Expected return from -6% to +15%

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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