

**BUY**

TP: Rs 695 | ▲ 17%

**AUROBINDO PHARMA**

Pharmaceuticals

12 August 2022

## Healthy growth but margin pressure persists

- Q1 revenue of Rs 62bn came in 5% above consensus as US business outperformed; however, EBITDA margin slid 570bps YoY to 15.5%
- Management confident of double-digit growth annually in specialty business to reach revenue of US\$ 650mn-700mn by FY24
- TP revised to Rs 695 (vs. Rs 680) as we adjust FY23-FY24 EPS by -9%/+2%; maintain BUY

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**Healthy growth led by US sales and ARV recovery:** ARBP reported Q1FY23 revenue of Rs 62.4bn, up 9% YoY (+7% QoQ) and 5% ahead of consensus on the back of above-expected growth in the US business (+11% YoY/9% QoQ). The company also saw strong recovery in antiretrovirals (ARV: +28% YoY/+61% QoQ), further aided by a spillover of business from the previous quarter. Europe revenue declined 2% YoY (flat QoQ) due to depreciation of the Euro against the USD. Emerging markets posted strong 31% YoY growth to Rs 4.3bn led by the Canada business and India formulation sales of Rs 456mn. APIs grew 12% YoY due to improved demand for few key products.

**US business posts positive surprise:** US market revenue rose 6.2% QoQ CC to US\$ 386mn on account of higher volumes. Price erosion stood at ~3% in Q1 (vs. 11% in Q4), but management expects stabilisation only after a couple of quarters.

**Margins guided to improve:** ARBP reported EBITDA margin contraction of 570bps YoY to 15.5% due to a 480bps slippage in gross margin alongside higher freight and other costs, plus additional expenses of Rs 600mn on account of production rescheduling. Other expenses were also higher owing to integration of the acquired domestic business. Management expects gross margin to improve from hereon.

**Earnings call highlights:** (1) Net organic capex of ~US\$ 61mn for the quarter includes investment of ~US\$ 8mn in a PLI project. (2) ARBP currently has 190 ANDAs under review.

**Retain BUY:** We revise margin assumptions post Q1, leading to a change of -9%/+2% in our FY23-FY24 EPS estimates. Our new TP is at Rs 695 (vs. Rs 680), based on an unchanged FY24E EV/EBITDA multiple of 7x (10.3x implied P/E). Our multiple reflects a continued 55% discount to other frontline stocks (SUNP, CIPLA, DRRD) due to ARBP's low branded sales and high US exposure. The stock is trading at attractive valuations of 7.5x/6.3x FY23E/FY24E EV/EBITDA – maintain BUY as we see limited downside and are optimistic of traction in specialty sales and rising launch momentum.

## Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	ARBP IN/Rs 593
Market cap	US\$ 4.4bn
Free float	48%
3M ADV	US\$ 13.2mn
52wk high/low	Rs 822/Rs 503
Promoter/FPI/DII	52%/22%/16%

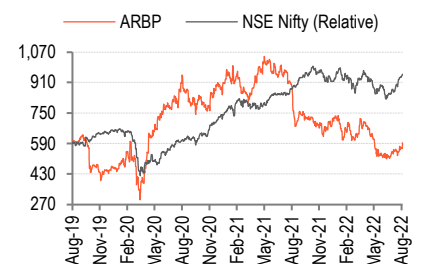
Source: NSE | Price as of 12 Aug 2022

## Key financials

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	2,34,555	2,50,134	2,65,089
EBITDA (Rs mn)	43,868	46,613	54,823
Adj. net profit (Rs mn)	27,062	27,271	33,560
Adj. EPS (Rs)	46.2	46.5	57.3
Consensus EPS (Rs)	46.2	54.3	62.4
Adj. ROAE (%)	11.6	10.5	11.7
Adj. P/E (x)	12.8	12.7	10.4
EV/EBITDA (x)	8.2	7.3	5.9
Adj. EPS growth (%)	12.0	0.8	23.1

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 (%)
<b>Net Sales</b>	<b>62,359</b>	<b>57,020</b>	<b>9.4</b>	<b>58,094</b>	<b>7.3</b>	<b>2,34,555</b>	<b>2,47,746</b>	<b>(5.3)</b>
<b>EBITDA</b>	<b>9,647</b>	<b>12,094</b>	<b>(20.2)</b>	<b>9,744</b>	<b>(1.0)</b>	<b>43,868</b>	<b>53,335</b>	<b>(17.8)</b>
Depreciation	2,795	2,797	-	2,536	-	11,265	10,554	-
EBIT	6,852	9,297	(26.3)	7,208	(4.9)	32,603	42,781	(23.8)
Interest	146	129	-	92	-	486	745	-
Other Income	406	813	-	292	-	2,504	2,773	-
PBT	7,112	9,981	(28.7)	7,408	(4.0)	34,620	44,809	(22.7)
Less: Taxation	1,586	2,477	-	175	-	7,256	20,041	-
Less: Minority Interest	38	90	-	38	-	302	543	-
<b>Recurring PAT</b>	<b>5,488</b>	<b>7,414</b>	<b>(26.0)</b>	<b>7,195</b>	<b>(23.7)</b>	<b>27,062</b>	<b>24,224</b>	<b>11.7</b>
Exceptional items	(283)	286	-	(1,430)	-	(580)	29,182	-
<b>Reported PAT</b>	<b>5,205</b>	<b>7,700</b>	<b>(32.4)</b>	<b>5,765</b>	<b>(9.7)</b>	<b>26,482</b>	<b>53,406</b>	<b>(50.4)</b>
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
Gross Margin	53.7	58.5	(479)	56.5	(284)	56.8	60.0	(326)
EBITDA Margin	15.5	21.2	(574)	16.8	(130)	18.7	21.5	(283)
Tax / PBT	22.3	24.8	-	2.4	-	21.0	44.7	-
NPM	8.8	13.0	-	12.4	-	11.5	9.8	-
EPS (Rs)	9.4	12.7	-	12.3	-	46.2	41.3	-

Source: Company, BOBCAPS Research

**Fig 2 – Revenue mix**

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
<b>Formulations</b>	<b>53,294</b>	<b>48,898</b>	<b>9.0</b>	<b>48,960</b>	<b>8.9</b>	<b>1,99,393</b>	<b>2,05,921</b>	<b>(3.2)</b>
US	29,711	26,812	10.8	27,281	8.9	1,11,221	1,12,306	(1.0)
Europe	15,481	15,829	(2.2)	15,407	0.5	64,803	60,608	6.9
EM	4,306	3,293	30.8	3,913	10.0	15,039	14,379	4.6
ARV	3,796	2,964	28.1	2,359	60.9	8,330	18,628	(55.3)
<b>APIs</b>	<b>9,065</b>	<b>8,119</b>	<b>11.7</b>	<b>9,129</b>	<b>(1.0)</b>	<b>35,156</b>	<b>30,859</b>	<b>13.9</b>
Dossier income	-	2	-	4	-	6	28	(78.6)
<b>Net Sales</b>	<b>62,359</b>	<b>57,020</b>	<b>9.4</b>	<b>58,094</b>	<b>7.3</b>	<b>2,34,555</b>	<b>2,36,808</b>	<b>(1.0)</b>
USDINR	77	74	4.5	75	2.5	74.5	74.1	0.5
US revenue (US\$ mn)	386	364	6.1	363	6.2	1,494	1,516	(1.5)

Source: Company, BOBCAPS Research

## Valuation methodology

We revise margin assumptions to factor in the Q1FY23 print, leading to a change of -9%/+2% in our FY23-FY24 EPS estimates. Our new TP stands at Rs 695 (vs. Rs 680), based on an unchanged FY24E EV/EBITDA multiple of 7x (10.3x implied P/E). Our multiple reflects a continued 55% discount to other frontline stocks (SUNP, CIPLA, DRRD) due to ARBP's low branded sales and high US exposure.

The stock is trading at attractive valuations of 7.5x/6.3x FY23E/FY24E EV/EBITDA – maintain BUY as we see limited downside from here and are optimistic of traction in specialty sales and increased launch momentum in coming years.

**Fig 3 – Revised estimates**

(Rs bn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	250.1	265.1	249.1	264.0	0.4	0.4
EBITDA	46.6	54.8	50.2	53.9	(7.1)	1.8
EBITDA Margin (%)	18.6	20.6	20.1	20.4	(151bps)	28bps
EPS (Rs)	46.6	57.3	51.1	56.3	(8.9)	1.8

Source: BOBCAPS Research

**Fig 4 – Key assumptions**

Revenue (Rs bn)	FY22	FY23E	FY24E
US	111.2	120.1	126.1
Europe	64.8	66.1	69.4
EM	15.0	16.1	17.7
ARV	8.3	9.6	10.3
API	35.2	38.2	41.6
Dossier Income	0.0	0.0	0.0

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)
					FY22E	FY23E	FY22E	FY23E	
Cipla	CIPLA IN	BUY	1,100	9.6	16.5	14.6	12.5	14.0	16.0
Dr. Reddy's	DRRD IN	HOLD	4,450	14.2	13.3	11.9	18.1	18.1	12.5
Sun Pharma	SUNP IN	BUY	1,100	13.6	17.2	15.3	17.8	18.0	18.5
Aurobindo Pharma	ARBP IN	BUY	695	11.8	7.2	6.1	12.5	14.0	7.0

Source: BOBCAPS Research

## Key risks

Key downside risks to our estimates are:

- **Price erosion in the US:** ARBP is facing price erosion in the US market which is affecting margins. Any further increase in competitive intensity will ratchet up margin pressure.
- **US approval delays:** Delays in key approvals and execution hurdles are risk factors.

- **Regulatory risk:** ARBP supplies to the US from multiple plants. Its key facilities are Unit 3, Unit 7, Unit 10, Eugia and Unit 4. Any adverse action by the USFDA at these facilities can impact our earnings estimates.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.1	1,278	1,500	BUY
Alembic Pharma	ALPM IN	1.6	653	770	HOLD
Alkem Labs	ALKEM IN	4.4	2,957	3,220	HOLD
Aurobindo Pharma	ARBP IN	4.4	593	695	BUY
Cipla	CIPLA IN	10.4	1,027	1,100	BUY
Divi's Labs	DIVI IN	12.4	3,726	4,250	HOLD
Dr Reddy's Labs	DRRD IN	8.9	4,261	4,450	HOLD
Eris Lifesciences	ERIS IN	1.2	695	970	BUY
Glenmark Life Sciences	GLS IN	0.7	438	560	BUY
Laurus Labs	LAURUS IN	3.8	566	645	BUY
Lupin	LPC IN	3.9	683	600	SELL
Sun Pharma	SUNP IN	27.5	913	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 12 Aug 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
<b>Total revenue</b>	<b>2,30,986</b>	<b>2,47,749</b>	<b>2,34,555</b>	<b>2,50,134</b>	<b>2,65,089</b>
EBITDA	48,247	53,337	43,868	46,613	54,823
Depreciation	9,667	10,554	11,265	12,377	13,531
EBIT	38,580	42,783	32,603	34,236	41,292
Net interest inc./(exp.)	(1,598)	(745)	(486)	(389)	(340)
Other inc./(exp.)	862	2,773	2,504	2,514	3,796
Exceptional items	0	0	0	0	0
EBT	37,844	44,811	34,620	36,361	44,747
Income taxes	8,994	20,098	7,256	9,090	11,187
Extraordinary items	(261)	29,182	(580)	0	0
Min. int./Inc. from assoc.	137	543	302	0	0
<b>Reported net profit</b>	<b>28,452</b>	<b>53,351</b>	<b>26,482</b>	<b>27,271</b>	<b>33,560</b>
Adjustments	261	(29,182)	580	0	0
<b>Adjusted net profit</b>	<b>28,714</b>	<b>24,170</b>	<b>27,062</b>	<b>27,271</b>	<b>33,560</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Accounts payables	25,450	27,947	27,030	30,838	32,682
Other current liabilities	30,745	29,831	30,400	30,016	31,811
Provisions	4,914	3,291	3,424	3,651	3,869
Debt funds	56,867	52,373	28,513	22,810	19,959
Other liabilities	0	0	0	0	0
Equity capital	586	586	586	586	586
Reserves & surplus	1,68,912	2,19,923	2,46,378	2,70,739	3,01,370
Shareholders' fund	1,69,498	2,20,509	2,46,964	2,71,325	3,01,956
<b>Total liab. and equities</b>	<b>2,87,473</b>	<b>3,33,950</b>	<b>3,36,331</b>	<b>3,58,641</b>	<b>3,90,277</b>
Cash and cash eq.	28,421	54,680	41,900	63,265	88,882
Accounts receivables	43,552	35,033	40,123	41,118	43,576
Inventories	76,999	90,266	75,539	78,809	79,890
Other current assets	19,130	23,711	26,006	20,261	21,472
Investments	5,547	5,910	9,972	9,972	9,972
Net fixed assets	64,948	68,866	77,284	79,708	80,977
CWIP	19,859	30,615	37,472	37,472	37,472
Intangible assets	29,017	24,870	28,036	28,036	28,036
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>2,87,474</b>	<b>3,33,950</b>	<b>3,36,331</b>	<b>3,58,641</b>	<b>3,90,277</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
<b>Cash flow from operations</b>	<b>45,455</b>	<b>55,282</b>	<b>45,361</b>	<b>45,167</b>	<b>46,538</b>
Capital expenditures	(17,500)	(14,000)	(14,800)	(14,800)	(14,800)
Change in investments	(1,945)	(363)	(4,061)	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(19,445)</b>	<b>(14,363)</b>	<b>(18,861)</b>	<b>(14,800)</b>	<b>(14,800)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(12,800)	(4,494)	(23,860)	(5,703)	(2,851)
Interest expenses	(1,598)	(745)	(486)	(389)	(340)
Dividends paid	(2,930)	(2,930)	(2,930)	(2,930)	(2,930)
Other financing cash flows	144	(6,492)	(12,003)	19	0
<b>Cash flow from financing</b>	<b>(17,184)</b>	<b>(14,660)</b>	<b>(39,279)</b>	<b>(9,002)</b>	<b>(6,121)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>8,827</b>	<b>26,258</b>	<b>(12,780)</b>	<b>21,365</b>	<b>25,617</b>
<b>Closing cash &amp; cash eq.</b>	<b>28,421</b>	<b>54,680</b>	<b>41,900</b>	<b>63,265</b>	<b>88,882</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22P	FY23E	FY24E
Reported EPS	48.6	91.1	45.2	46.5	57.3
Adjusted EPS	49.0	41.3	46.2	46.5	57.3
Dividend per share	2.5	2.5	2.5	2.5	2.5
Book value per share	289.6	376.8	422.0	463.6	516.0

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22P	FY23E	FY24E
EV/Sales	1.7	1.6	1.5	1.4	1.2
EV/EBITDA	8.1	7.3	8.2	7.3	5.9
Adjusted P/E	12.1	14.4	12.8	12.7	10.4
P/BV	2.0	1.6	1.4	1.3	1.2

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22P	FY23E	FY24E
Tax burden (Net profit/PBT)	75.9	53.9	78.2	75.0	75.0
Interest burden (PBT/EBIT)	98.1	104.7	106.2	106.2	108.4
EBIT margin (EBIT/Revenue)	16.7	17.3	13.9	13.7	15.6
Asset turnover (Rev./Avg TA)	26.5	24.8	21.4	22.0	21.5
Leverage (Avg TA/Avg Equity)	1.4	1.3	1.2	1.1	1.1
Adjusted ROAE	18.6	12.4	11.6	10.5	11.7

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22P	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	18.1	7.3	(5.3)	6.6	6.0
EBITDA	22.1	10.5	(17.8)	6.3	17.6
Adjusted EPS	19.0	(15.8)	12.0	0.8	23.1
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	20.9	21.5	18.7	18.6	20.7
EBIT margin	16.7	17.3	13.9	13.7	15.6
Adjusted profit margin	12.4	9.8	11.5	10.9	12.7
Adjusted ROAE	18.6	12.4	11.6	10.5	11.7
ROCE	18.1	18.2	12.8	12.9	14.6
<b>Working capital days (days)</b>					
Receivables	69	52	62	60	60
Inventory	122	133	118	115	110
Payables	40	41	42	45	45
<b>Ratios (x)</b>					
Gross asset turnover	1.9	1.8	1.6	1.5	1.5
Current ratio	2.8	3.3	3.0	3.2	3.4
Net interest coverage ratio	24.1	57.4	67.0	88.0	121.3
Adjusted debt/equity	0.2	0.0	(0.1)	(0.1)	(0.2)

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

## Disclaimer

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

**BUY** – Expected return >+15%

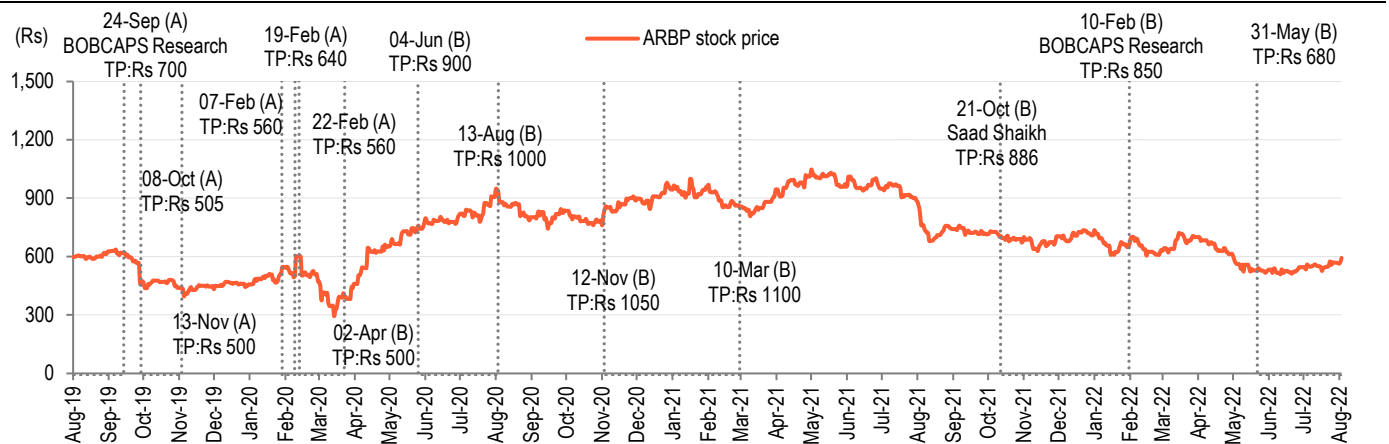
**HOLD** – Expected return from -6% to +15%

**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): AUROBINDO PHARMA (ARBP IN)



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

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