

BUY

TP: Rs 1,050 | ▲ 30%

AUROBINDO PHARMA

Pharmaceuticals

12 November 2020

Q2 beat; growing balance sheet comfort merits higher multiple

Aurobindo Pharma's (ARBP) Q2 EBITDA was 13% above estimates, led by an all-round sales beat of 7% and multiyear-high gross margins of 61.2%. Rebound in US injectables, Europe and ARV sales surprised positively. Management expects to sustain Q2 sales momentum but sees gross margin settling at ~60%. It is confident of sustaining 6-8% sales growth in the long run. Injectable unit commissioning and biosimilar/depo-injection filings are key near-term events in FY21. We raise FY22/ FY23 EPS by 4% each. Retain BUY; Sep'21 TP revised to Rs 1,050 (vs. Rs 1,000).

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Positive surprises in US injectables, Europe and ARVs: US sales rebounded to US\$ 434mn (+5% QoQ) on sharp recovery in injectables (\$65mn, +28%) while oral sales were stable (\$274mn, -1%). EU grew 15% QoQ, ARV 18% (higher TLD migration) and EM 54%. Commentary across businesses was positive and ARBP expects US injectable sales to double to US\$ 700mn in three years. Led by 27 launches for the rest of FY21 (23 in H1) and injectable unit commissioning in Q4, we expect >6% US sales growth for FY20-FY22. A favourable injectable mix led to peak gross margins of 61.2% in Q2 (+180bps QoQ; 59% est.).

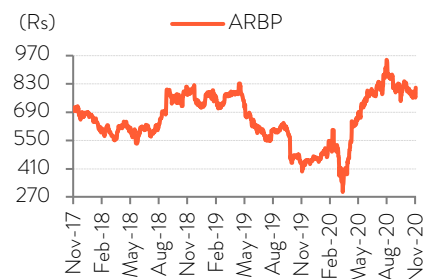
Earnings takeaways: (1) Natrol divestment proceeds to be used towards building injectable capacity for EU/US. (2) Covid vaccine unit to be ready by Mar-Apr'21 (450mn doses). (3) R&D spends at 6.3% of sales in Q2 (4.3% in Q1); ARBP expects this at 5.5% in FY21. (4) ARV: 20% market share in TLD; management believes market can expand further to 14mn packs from 8mn. (5) Biosimilars: Filings for three assets in EU and one in US by FY21-end.

Solid US execution, balance sheet comfort to support higher valuation: ARBP trades at 8x FY23E EBITDA (8Y band: 5-15x), 25% above global peers. Strong US pipeline execution, a nimble supply chain and balance sheet comfort can drive upsides to our EPS and FCF, supporting a higher multiple in the next 12 months.

Ticker/Price	ARBP IN/Rs 811
Market cap	US\$ 6.4bn
Shares o/s	586mn
3M ADV	US\$ 42.5mn
52wk high/low	Rs 968/Rs 289
Promoter/FPI/DII	52%/19%/15%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	195,634	230,986	249,002	254,638	269,765
EBITDA (Rs mn)	39,519	48,640	52,910	54,250	57,539
Adj. net profit (Rs mn)	24,126	28,911	31,980	33,867	36,309
Adj. EPS (Rs)	41.2	49.3	54.6	57.8	62.0
Adj. EPS growth (%)	(0.4)	19.8	10.6	5.9	7.2
Adj. ROAE (%)	18.8	18.7	16.2	14.1	13.3
Adj. P/E (x)	19.7	16.4	14.9	14.0	13.1
EV/EBITDA (x)	12.8	10.6	9.7	8.9	7.8

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	Q2FY21E	Var (%)	H1FY21	H1FY20	YoY (%)
Net Sales	64,832	56,005	15.8	59,248	9.4	60,601	7.0	124,080	110,450	12.3
EBITDA	14,326	11,675	22.7	12,573	13.9	12,729	12.5	26,900	23,140	16.2
Depreciation	2,573	2,433	-	2,555	-	2,555	-	5,128	4,841	-
EBIT	11,753	9,242	27.2	10,018	17.3	10,174	-	21,772	18,299	19.0
Interest	157	409	-	211	-	211	-	368	908	-
Other Income	472	206	-	934	-	400	-	1,406	316	-
PBT	12,068	9,039	33.5	10,741	12.4	10,364	16.4	22,810	17,707	28.8
Less: Taxation	3,873	2,244	-	3,038	-	2,591	-	6,911	4,521	-
Less: Minority Interest	205	0	-	120	-	0	-	325	0	-
Recurring PAT	7,990	6,795	17.6	7,584	5.4	7,773	2.8	15,574	13,186	18.1
Exceptional items	66	(399)	-	222	-	0	-	288	(525)	-
Reported PAT	8,056	6,396	26.0	7,806	3.2	7,773	3.6	15,862	12,661	25.3
Key Ratios (%)										
Gross Margin	61.2	57.7	-	59.4	-	58.7	-	60.3	57.7	-
EBITDA Margin	22.1	20.8	-	21.2	-	21.0	-	21.7	21.0	-
Tax / PBT	32.1	24.8	-	28.3	-	25.0	-	30.3	25.5	-
NPM	12.3	12.1	-	12.8	-	12.8	-	12.6	11.9	-
EPS (Rs)	13.6	11.6	-	12.9	-	13.3	-	26.6	22.5	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	Q2FY21E	Var (%)	H1FY21	H1FY20	YoY (%)
Formulations	56,538	47,939	17.9	51,444	9.9	52,877	6.9	107,982	95,058	13.6
US	31,898	28,355	12.5	31,071	2.7	31,385	1.6	62,969	55,239	14.0
Europe	15,148	14,013	8.1	13,222	14.6	14,015	8.1	28,370	27,929	1.6
EM	4,465	3,192	39.9	2,896	54.2	3,671	21.6	7,361	6,326	16.4
ARV	5,027	2,379	111.3	4,255	18.1	3,806	32.1	9,282	5,564	66.8
APIs	8,290	8,058	2.9	7,801	6.3	7,719	7.4	16,091	15,380	4.6
Net Sales	64,834	56,005	15.8	59,248	9.4	60,601	7.0	124,061	110,438	12.3
INR/US\$	74	70	5.0	75	(2.0)	73.5	-	74	70	6.1
US in \$ terms	434	405	7.1	414	4.8	427	1.6	848	789	7.5

Source: Company, BOBCAPS Research

FIG 3 – US SALES SPLIT

(US\$ mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Oral solid	274	255	7.3	277	(1.1)
Generic Injectables	65	77	(15.0)	51	28.1
Natrol	56	41	39.1	51	9.7
Branded Injectables (Spectrum)	24	20	19.1	26	(5.2)
OTC	14	12	17.0	10	49.3
Total	434	405	7.1	414	4.8

Source: Company, BOBCAPS Research

Valuation methodology

Three sites will be critical to drive growth for ARBP in the coming years, i.e. Units 4, 10 and Eugia. Together these account for ~70% of the company's pending ANDAs. All of these units have cleared USFDA inspections recently. We assume a low probability of any significant impact from the Aurolife unit warning letter, given limited pending approvals (~5% of total pending ANDAs) and low contribution to US business (~2% of total sales).

We increase our FY22/FY23 EPS estimates by ~4% each after adjusting for the Natrol divestment and raising margin assumptions by 50bps on an improving mix in favour of injectables and reduction in interest cost. The stock is trading at 8x FY23E EBITDA (vs. the eight-year historical band of 5-15x), which is ~25% higher than global peers Teva, Endo, Mylan and Perrigo.

Given progressive buildup of a diverse and robust specialty product portfolio (across inhalers, nasal drugs, oncology/hormone therapy, depo-injections, biosimilars and vaccines), the growth outlook remains buoyant and we see further upside risk to our FY21/FY22 EPS estimates. This together with growing balance sheet comfort could fuel multiple expansion over the next 12 months, with net-debt/EBITDA (0.5x in FY20) moving into net cash (1x EBITDA in FY22E) and FCF yield at 5-6% after providing for US\$ 250mn+ in annual capex.

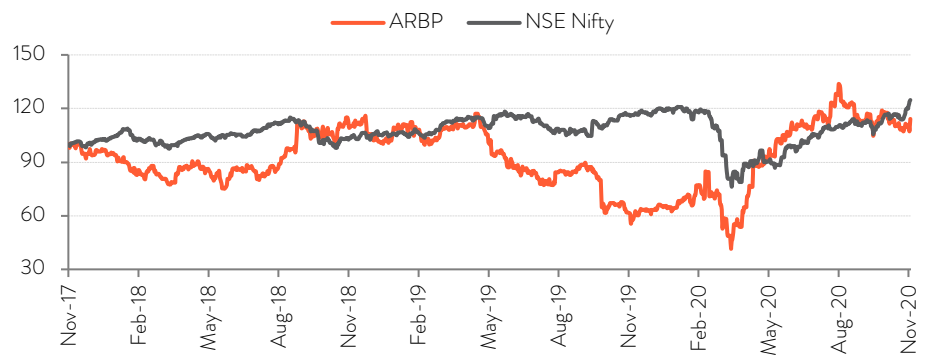
We retain BUY with a revised Sep'21 target price of Rs 1,050 (from Rs 1,000), based on an unchanged 11x EV/EBITDA (implied 18x P/E). Our target multiple reflects a continued 25-30% discount to other frontline stocks (Cipla, Dr Reddy's, Lupin) due to ARBP's low branded sales and high US exposure. Penalty risk from the Aceto supply-chain sabotage claim (in the US District Court) is a key downside risk.

FIG 4 – REVISED ESTIMATES

(Rs bn)	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Sales	249	255	270	246	261	277	1.4	(2.5)	(2.6)
EBITDA	53	54	58	51	54	58	3.4	(0.1)	(0.2)
EBITDA margin (%)	21.2	21.3	21.3	20.8	20.8	20.8	42bps	51bps	51bps
EPS (Rs)	54.6	57.8	62.0	53.6	55.7	59.7	1.8	3.8	3.8

Source: Company, BOBCAPS Research

FIG 5 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **US approval delays:** The US forms the single largest delta in our operating profit estimates for FY21-FY22 (>60% of profit); hence, delays in key approvals and execution hurdles are key 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 EPS estimates.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	195,634	230,986	249,002	254,638	269,765
EBITDA	39,519	48,640	52,910	54,250	57,539
Depreciation	6,680	9,667	10,358	11,478	12,598
EBIT	32,839	38,973	42,552	42,772	44,941
Net interest income/(expenses)	(2,626)	(1,597)	(967)	(836)	(334)
Other income/(expenses)	1,157	862	2,223	3,220	3,805
Exceptional items	0	0	0	0	0
EBT	31,370	38,238	43,809	45,156	48,412
Income taxes	7,268	9,134	11,828	11,289	12,103
Extraordinary items	(483)	(705)	26,640	0	0
Min. int./Inc. from associates	(25)	193	0	0	0
Reported net profit	23,642	28,206	58,620	33,867	36,309
Adjustments	483	705	(26,640)	0	0
Adjusted net profit	24,126	28,911	31,980	33,867	36,309

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	26,771	25,450	34,110	34,882	36,954
Other current liabilities	24,390	30,745	29,880	30,557	32,372
Provisions	2,273	4,914	5,297	5,417	5,739
Debt funds	69,668	56,867	39,807	15,923	6,369
Other liabilities	0	0	0	0	0
Equity capital	586	586	586	586	586
Reserves & surplus	138,686	168,912	224,602	255,539	288,919
Shareholders' fund	139,272	169,498	225,187	256,125	289,505
Total liabilities and equities	262,373	287,473	334,281	342,903	370,938
Cash and cash eq.	19,594	28,421	52,419	54,923	71,906
Accounts receivables	47,771	43,552	57,987	62,787	66,517
Inventories	72,456	76,999	78,453	76,740	81,299
Other current assets	17,518	19,130	22,410	22,917	24,279
Investments	3,602	5,547	5,547	5,547	5,547
Net fixed assets	56,936	64,948	68,590	71,112	72,514
CWIP	16,685	19,859	19,859	19,859	19,859
Intangible assets	27,811	29,017	29,017	29,017	29,017
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	262,373	287,474	334,281	342,903	370,938

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	30,322	37,873	68,978	45,345	48,907
Interest expenses	2,626	1,597	967	836	334
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(15,780)	5,738	(10,990)	(2,027)	(5,441)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	17,168	45,208	58,955	44,154	43,800
Capital expenditures	(26,028)	(17,500)	(14,000)	(14,000)	(14,000)
Change in investments	(487)	(1,945)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(26,515)	(19,445)	(14,000)	(14,000)	(14,000)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	21,958	(12,800)	(17,060)	(23,884)	(9,554)
Interest expenses	(2,626)	(1,597)	(967)	(836)	(334)
Dividends paid	(2,930)	(2,930)	(2,930)	(2,930)	(2,930)
Other financing cash flows	(77)	391	(1)	0	0
Cash flow from financing	16,325	(16,937)	(20,958)	(27,650)	(12,818)
Changes in cash and cash eq.	6,978	8,827	23,998	2,505	16,983
Closing cash and cash eq.	19,594	28,421	52,419	54,923	71,906

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	40.4	48.1	100.1	57.8	62.0
Adjusted EPS	41.2	49.3	54.6	57.8	62.0
Dividend per share	2.5	2.5	2.5	2.5	2.5
Book value per share	238.0	289.6	384.8	437.7	494.7

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	2.6	2.2	2.1	1.9	1.7
EV/EBITDA	12.8	10.6	9.7	8.9	7.8
Adjusted P/E	19.7	16.4	14.9	14.0	13.1
P/BV	3.4	2.8	2.1	1.9	1.6

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	76.9	75.6	73.0	75.0	75.0
Interest burden (PBT/EBIT)	95.5	98.1	103.0	105.6	107.7
EBIT margin (EBIT/Revenue)	16.8	16.9	17.1	16.8	16.7
Asset turnover (Revenue/Avg TA)	26.1	26.5	25.3	23.7	23.8
Leverage (Avg TA/Avg Equity)	1.5	1.4	1.2	1.1	1.0
Adjusted ROAE	18.8	18.7	16.2	14.1	13.3

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	18.8	18.1	7.8	2.3	5.9
EBITDA	4.8	23.1	8.8	2.5	6.1
Adjusted EPS	(0.4)	19.8	10.6	5.9	7.2
Profitability & Return ratios (%)					
EBITDA margin	20.2	21.1	21.2	21.3	21.3
EBIT margin	16.8	16.9	17.1	16.8	16.7
Adjusted profit margin	12.3	12.5	12.8	13.3	13.5
Adjusted ROAE	18.8	18.7	16.2	14.1	13.3
ROCE	18.2	18.3	18.2	17.1	17.2
Working capital days (days)					
Receivables	89	69	85	90	90
Inventory	135	122	115	110	110
Payables	50	40	50	50	50
Ratios (x)					
Gross asset turnover	1.9	1.9	1.8	1.7	1.6
Current ratio	2.9	2.8	3.0	3.1	3.3
Net interest coverage ratio	12.5	24.4	44.0	51.2	134.4
Adjusted debt/equity	0.4	0.2	(0.1)	(0.2)	(0.2)

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

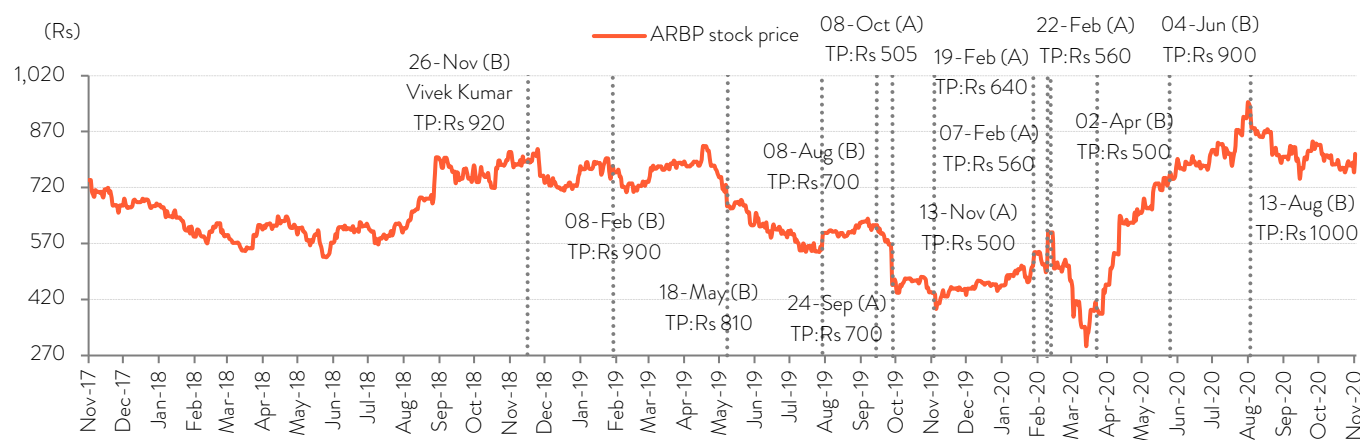
ADD – Expected return from >+5% to +15%

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): AUROBINDO PHARMA (ARBP IN)



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

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