

Aurobindo Pharma

Pharma

Result update

15 November 2016

Enhanced cost efficiencies, maintain Buy

We maintain Buy rating for Aurobindo Pharma (APL), with a TP of Rs1,060 based on 18x March'18E EPS of Rs58.7. APL's Q2FY17 results were in line with our expectation. APL reported 12% YoY sales growth, 140bps margin improvement to 24.6% and 34%YoY net profit growth. Entry into specialised segments of injectable, penam, microspheres, hormones, oncology, depot injections and peptides would help improve margins. APL has developed a strong pipeline of 412 ANDA for the US market. The management expects approval for several injectable in FY17. APL is among our top picks in the pharma sector.

- **US formulations grew 18%YoY:** APL's formulations business (80% of revenues) grew by 12%YoY to Rs30.04bn from Rs26.73bn, led by strong growth in the US business. Its US formulations (46% of revenues) grew by 18% YoY to Rs17.35bn from Rs14.73bn due to new product launches. Formulations in the EU and RoW (26% of revenues) grew by 8% YoY to Rs9.90bn from Rs9.20bn due to good growth of Actavis business. ARV formulations business (7% of revenues) was flat at Rs2.80bn. The company's API business (20% of revenues) grew by 11% YoY to Rs7.69bn from Rs6.91bn. The management expects the US business to drive future growth from new launches.
- **Margins grew by 140bpsYoY:** APL's EBITDA margins improved by 140bpsYoY to 24.6% from 23.2% due to decline in material cost. Its material cost declined by 170bps to 43.2% from 44.9%. Personnel expenses grew by 20bps to 11.3% from 11.1%. Other expenses grew by 10bps to 20.9% from 20.8%. We expect new product launches, ARV tender supplies, controlled substances and injectable businesses in the US to aid in margin improvement.
- **Net profit grew by 34% YoY:** APL's net profit grew by 34% YoY to Rs6.06bn from Rs4.54bn due to margin improvement and lower tax rate. The company's other income declined by 32% YoY to Rs83mn from Rs122mn. The company's tax rate declined to 27% from 28% of PBT. Forex gain was Rs202mn as against forex loss of Rs439mn. We expect its net profit to grow led by strong revenue growth and expected margin improvement.
- **Attractive valuations and key risks:** We expect APL to report good performance, driven by strong growth in the US market from controlled substances, new ANDA approvals and injectable business. The company could benefit from ARV tender supplies. We maintain Buy rating on the scrip, with a TP of Rs1,060 based on 18x March'18E EPS of Rs58.7, and with an upside of 37.3% from CMP. APL is among our top picks in the pharma sector. Key risks to our assumptions include slower growth in the US business and regulatory risks for its manufacturing facilities.

Particulars (Rs mn)	Q2FY17	Q2FY16	YoY (%)	Q1FY17	QoQ (%)	Q2FY17E	% Var.
Total income	37,755	33,652	12.2	37,666	0.2	39,453	(4.3)
Total Expenditure	28,463	25,860	10.1	28,777	(1.1)	29,930	(4.9)
EBIDTA	9,292	7,792	19.3	8,889	4.5	9,523	(2.4)
EBIDTA Margin (%)	24.6	23.2		23.6		24.1	
Other income	83	122	(32.0)	159	(47.8)	160	(48.1)
PBDIT	9,375	7,914	18.5	9,048	3.6	9,683	(3.2)
Forex exchange gain / (loss)	202	(439)	(146.0)	70	188.6	60	NA
PBT	8,300	6,308	31.6	7,850	5.7	8,363	(0.8)
Prov. For tax	2,240	1,767	26.8	2,008	11.6	2,200	1.8
Tax rate	27.0	28.0		25.6		26.3	
PAT	6,060	4,541	33.5	5,842	3.7	6,163	(1.7)
Minority Interest/Sh of profit of asso.	(4)	(5)		8		10	(140.0)
PAT after Min Int & share of P&L Asso.	6,056	4,536	33.5	5,850	3.5	6,173	(1.9)

Source: Company, Centrum Research Estimates

Y/E Mar (Rs mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adj. PAT	YoY (%)	DEPS Rs.	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY14	80,995	38.3	21,315	26.3	11,724	298.8	20.0	36.9	20.5	38.5	12.2
FY15	121,204	49.6	25,636	21.2	15,758	34.4	26.9	35.4	19.9	28.7	10.1
FY16	138,887	14.6	31,983	23.0	19,747	25.3	33.8	32.4	20.2	22.9	15.1
FY17E	170,770	23.0	41,181	24.1	26,561	34.5	45.4	32.1	22.2	17.0	11.4
FY18E	198,655	16.3	49,995	25.2	34,345	29.3	58.7	31.0	25.0	13.1	9.0

Source: Company, Centrum Research Estimates

In the interest of timeliness, this document is not edited.

Centrum Equity Research is available on Bloomberg, Thomson Reuters and FactSet

Target Price	Rs1,060	Key Data	
CMP*	Rs772	Bloomberg Code	ARBP IN
Upside	37.3%	Curr Shares O/S (mn)	584.0
Previous Target	Rs1,060	Diluted Shares O/S(mn)	584.0
Previous Rating	Buy	Mkt Cap (Rsbn/USDbn)	451.9/6.7
Price Performance (%)*		52 Wk H / L (Rs)	895/582
		5 Year H / L (Rs)	895/40.1
ARBP IN	(6.2)	(1.5)	(6.9)
Nifty	(5.7)	3.6	4.3
		Daily Vol. (3M NSE Avg.)	2599776

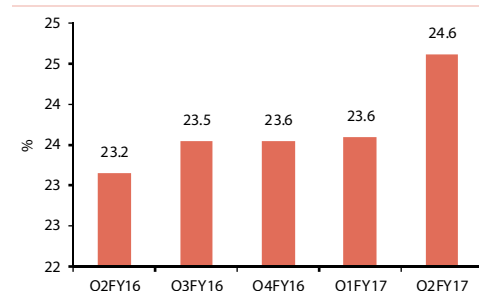
*as on 11th November 2016; Source: Bloomberg, Centrum Research

Shareholding pattern (%)*

	Sept-16	June-16	Mar-16	Dec-15
Promoter	53.8	53.8	53.8	53.9
FIs	26.7	26.1	27.4	28.8
DIs	7.8	8.0	7.2	6.5
Others	11.7	12.1	11.6	10.8

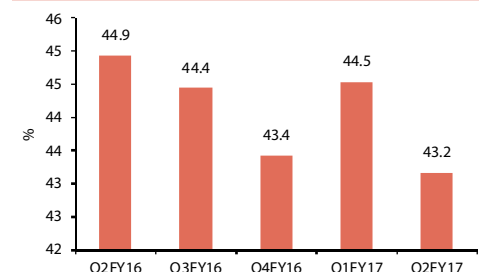
Source: BSE, *as on 11th November 2016

Trend in EBITDA margin (%)



Source: Company, Centrum Research

Trend in material cost (%)



Source: company, Centrum Research

Centrum vs. Bloomberg Consensus*

Particulars (Rs bn)	FY17E			FY18E		
	Centrum	BBG	Var (%)	Centrum	BBG	Var (%)
Sales	170.8	159.8	6.9	198.7	181.5	9.4
EBITDA	41.2	38.3	7.6	50.0	44.6	12.0
PAT	26.6	24.7	7.7	34.3	29.4	16.9

Bloomberg Consensus*				Centrum Target Price (Rs)	Variance (%)
BUY	SELL	HOLD	Target Price (Rs)		
34	1	2	962	1,060	10.2

*as on 11th November 2016 Source: Bloomberg, Centrum Research

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Concall highlights

Major products and key markets

- The management indicated filing of 9 ANDA with US FDA (6 oral, 3 injectable) during the quarter. APL received approval for 15 ANDA (10 oral, 5 injectable).
- As per management 11 new products were launched in Q2FY17(7 oral, 4 injectable).
- The integration of acquired Natrol business is in line with management's expectations.
- The management expects higher number of approvals in H2FY17.
- The management indicated that 37 products of Actavis have been site transferred to Vizag, and has plans to transfer 72 more products to Vizag.
- APL plans to enter new therapeutic areas in the US, such as oncology, microsphere, peptide, liposomal, hormones, oral contraceptives, depot injections and complex substance filings. The upside from these businesses is expected FY18 onwards.
- The management indicated the vertical integration of in-house API ~70%.
- The management indicated pricing pressure in the US with 6-7% reduction in prices.

US FDA approvals and new product launches

- APL filed 412 ANDAs with US FDA, of which 284 are approved (including 41 tentative); hence, it has a rich product pipeline for the US market. APL has developed a pipeline of 15 injectable oncology products for the US market. The company has received tentative approval for 21 ANDAs under PEPFAR.
- The management indicated that no major observations are pending from US FDA about the manufacturing facilities.
- As per the management, APL has filed 3 DMF for peptides and has plans to generate strong pipeline.
- APL had filed 210 DMFs with US FDA.
- The Vizag facility has been approved by UK MHRA and commercial sales would commence from January'17.

Financials

- The management indicated a net debt of \$484mn (Rs31.9bn) by end of Q2FY17. About 98% of the debt is in foreign currency. The average interest cost is ~2%.
- Forex gain was Rs202mn as against forex loss of Rs439mn.
- The management has guided for R&D expenses of ~5.0% of revenues during FY17. This is likely to surge to 7-8% in FY18.
- The management indicated reduction in the material cost due to change in product mix.
- As per management, the increase in inventory was due to products manufactured and ready for launch in the US and higher inventory in anticipation of increase in the US business.

APL incurred \$40mn (Rs2.6bn) on capex in Q2FY17.

Sales Composition

For Q2FY17, APL has reported 12% YoY revenue growth to Rs37.76bn from Rs33.65bn, led by strong growth in its US formulations business. APL's formulations business (80% of revenues) grew by 12% YoY to Rs30.04bn from Rs26.73bn, driven by robust growth in the US market. Formulations sales in the US (46% of revenues) grew by 18% YoY to Rs17.35bn from Rs14.73bn due to Natrol integration and new product launches. Formulations sales in the EU and RoW (26% of revenues) grew by 8% YoY to Rs9.90bn from Rs9.20bn due to good growth of Actavis business. APL's ARV formulations business (7% of revenues) was maintained at Rs2.80bn. The growth in formulations business was mainly driven by the US business.

The company's API business (20% of revenues) grew by 11%YoY to Rs7.69bn from Rs6.91bn due to higher growth of betalactum products. The vertical integration of in-house API was ~70%. Betalactam API business (13% of revenues) grew by 20%YoY to Rs5.11bn from Rs4.28bn. Non-betalactam API business (7% of revenues) declined by 2% YoY to Rs2.58bn from Rs2.64bn.

The details are as follows:

Exhibit 1: Sales composition

Particulars (Rs mn)	Q2FY17	Q2FY16	YoY (%)	Q1FY17	QoQ (%)	Q2FY17E	% Var.
FORMULATIONS							
Formulations-USA	17,351	14,727	17.8	17,039	1.8	18,453	(6.0)
Formulations-EU & ROW	9,902	9,203	7.6	10,252	(3.4)	10,800	(8.3)
Formulations-ARV	2,785	2,802	(0.6)	3,030	(8.1)	3,400	(18.1)
Formulations-total	30,038	26,732	12.4	30,321	(0.9)	32,653	(8.0)
API							
API-Betalactum	5,113	4,275	19.6	4,950	3.3	4,180	22.3
API- Non betalactum	2,575	2,636	(2.3)	2,396	7.5	2,600	(1.0)
API-Total	7,688	6,911	11.2	7,346	4.7	6,780	13.4
Dossier income	28	9	211.1	0 NA		20	40.0
Total income	37,754	33,652	12.2	37,667	0.2	39,453	(4.3)

Source: Company, Centrum Research

Acquisitions well- integrated

The Actavis generics business in Europe and Natrol nutraceutical business in the US are well integrated with APL and are performing well. Actavis business reported high single digit EBIDTA margin in Q2FY17. Also, Natrol performed in line with management's expectations.

We expect APL to report good performance, driven by strong growth in the US market from controlled substances, new ANDA approvals and injectables business. The company is likely to benefit from ARV tender supplies.

At the CMP of Rs772, the stock trades at 17.0x FY17E EPS of Rs45.4 and 13.1x FY18E EPS of Rs58.7. We maintain Buy rating on the scrip, with a TP of Rs1,060 based on 18x March'18E EPS of Rs58.7, and with an upside of 37.3% from CMP. APL is among our top picks in the pharma sector. Key risks to our assumptions include slower growth in the US business and regulatory risks for its manufacturing facilities.

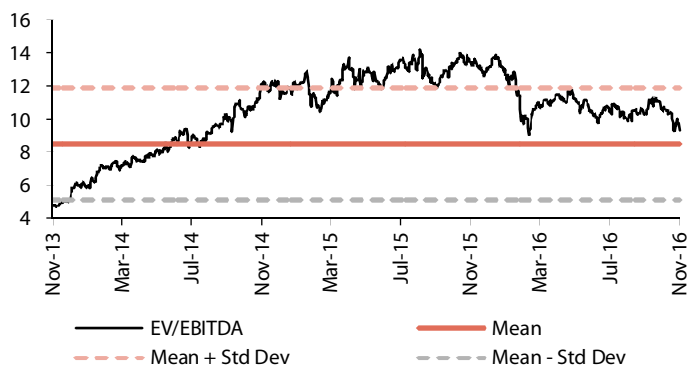
Valuation

Exhibit 2: Sensitivity Analysis

Sensitivity to key variables – FY17E	% change	% impact on EBITDA	% impact on EPS
Sales	1	4.1	6.4
Material cost	1	(1.8)	(2.8)

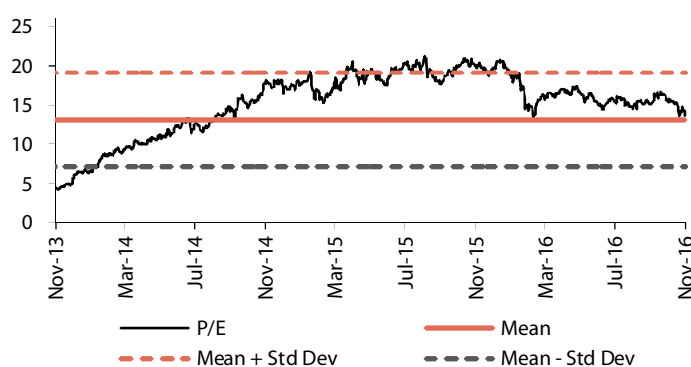
Source: Company, Centrum Research Estimates

Exhibit 3: 1 year forward EV/EBITDA chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 4: 1 year forward P/E chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 5: Comparative Valuations

Sector	Mkt Cap (Rs mn)	CAGR FY16-FY18E (%)			EBITDA Margin (%)			PE (x)			EV/EBITDA (x)			RoE (%)			Div Yield (%)		
		Rev.	EBITDA	PAT	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E
Aurobindo	451,620	19.6	25.0	31.9	23.0	24.1	25.2	22.9	17.0	13.1	15.1	11.4	9.0	32.4	32.1	31.0	0.3	0.4	0.5
Cipla	440,263	15.4	18.1	16.3	18.3	17.8	19.2	29.2	28.7	21.6	19.5	16.9	13.1	13.3	12.0	14.0	0.4	0.5	0.6
Dr. Reddy's Labs	539,194	8.1	8.3	17.1	24.0	23.6	24.2	26.9	23.5	20.3	15.5	13.6	11.8	16.6	16.2	15.8	0.6	0.8	0.9
Lupin	657,280	18.8	23.5	24.9	26.4	27.7	28.5	28.9	22.2	18.5	19.4	14.5	12.2	22.9	23.9	23.1	0.5	0.6	0.7

Source: Company, Centrum Research Estimates Prices as on 11th November 2016

Quarterly financials, Operating Metrics and Key Performance Indicators

Exhibit 6: Quarterly Financials -consolidated

PARTICULARS (Rs mn)	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17
P & L								
Revenues	31,662	31,621	32,989	33,652	34,956	37,468	37,666	37,755
Material cost	15,385	13,736	15,124	15,121	15,536	16,271	16,777	16,299
Personnel expenses	3,680	3,733	3,612	3,730	4,010	4,088	4,321	4,266
Other Expenses	6,474	7,591	7,003	7,009	7,179	8,285	7,679	7,898
Total Expenses	25,539	25,060	25,739	25,860	26,725	28,644	28,777	28,463
EBIDTA	6,123	6,561	7,251	7,792	8,231	8,824	8,889	9,292
Other income	359	67	294	122	69	206	159	83
PBDIT	6,482	6,628	7,544	7,914	8,300	9,030	9,048	9,375
Interest	219	226	208	241	227	251	206	175
Depreciation	673	847	890	926	995	1,113	1,062	1,102
Forex gain /(loss)	(202)	12	(106)	(439)	129	46	70	202
Profit before tax	5,388	5,567	6,340	6,308	7,207	7,712	7,850	8,300
Tax provision	1,563	1,534	1,634	1,767	1,860	2,097	2,008	2,240
Net profit before minority	3,825	4,033	4,706	4,541	5,347	5,615	5,842	6,060
Share of profit of JV	(20)	(5)	19	(5)	(3)	(14)	8	(4)
Net profit	3,845	4,038	4,725	4,536	5,344	5,601	5,850	6,056
Growth (%)								
Revenues	47.9	35.7	13.3	16.8	10.4	18.5	14.2	12.2
EBIDTA	(4.9)	(11.7)	10.2	22.3	34.4	34.5	22.6	19.3
Net profit	(7.9)	(19.5)	13.7	21.9	39.0	38.7	23.8	33.5
Margin (%)								
EBIDTA	19.3	20.7	22.0	23.2	23.5	23.6	23.6	24.6
Profit before tax	17.0	17.6	19.2	18.7	20.6	20.6	20.8	22.0
Net margin before EO	12.1	12.8	14.3	13.5	15.3	14.9	15.5	16.0

Source: Company, Centrum Research

Exhibit 7: Key performance indicators

Key performance indicator	FY14	FY15	FY16	FY17E	FY18E
Sales Growth %	38.3	49.6	14.6	23.0	16.3
Material cost %	44.5	45.4	44.3	44.0	43.3

Source: Centrum Research Estimates

Financials -consolidated

Exhibit 8: Income Statement

Y/E March (Rs mn)	FY14	FY15	FY16	FY17E	FY18E
Net Sales	80,995	121,204	138,887	170,770	198,655
-Growth (%)	38.3	49.6	14.6	23.0	16.3
Material Cost	36,061	55,055	61,575	75,060	85,930
% of sales	44.5	45.4	44.3	44.0	43.3
Personnel Expenses	8,320	13,023	15,508	19,060	21,810
% of sales	10.3	10.7	11.2	11.2	11.0
Other Expenses	15,298	27,490	29,821	35,469	40,920
% of sales	18.9	22.7	21.5	20.8	20.6
Operating Expenses	59,679	95,568	106,904	129,589	148,660
% of sales	73.7	78.8	77.0	75.9	74.8
EBIDTA	21,315	25,636	31,983	41,181	49,995
-EBIDTA margin (%)	26.3	21.2	23.0	24.1	25.2
Depreciation	3,125	3,326	3,926	4,700	5,300
EBIT	18,190	22,310	28,057	36,481	44,695
Interest Income/(expenses)	(1,080)	(843)	(927)	(800)	(550)
Forex gain / (loss) on loans	(2,022)	(596)	(660)	-	-
PBT from operations	15,088	20,871	26,470	35,681	44,145
Other non operating income	232	808	682	1,000	2,300
PBT	15,321	21,679	27,152	36,681	46,445
-PBT margin (%)	18.9	17.9	19.5	21.5	23.4
Provision for tax	3,634	5,966	7,444	10,200	12,200
Effective tax rate (%)	23.7	27.5	27.4	27.8	26.3
Minority Interest	38	45	39	80	100
Net profit	11,724	15,758	19,747	26,561	34,345
Adj. PAT	11,724	15,758	19,747	26,561	34,345

Source: Company, Centrum Research Estimates

Exhibit 9: Key Ratios

Y/E March	FY14	FY15	FY16	FY17E	FY18E
Growth Matrices (%)					
Net sales	38.3	49.6	14.6	23.0	16.3
EBIDTA	147.6	20.3	24.8	28.8	21.4
Adjusted PAT	298.8	34.4	25.3	34.5	29.3
Profitability Matrices (%)					
EBIDTA margin	26.3	21.2	23.0	24.1	25.2
EBIT margin	22.7	19.1	20.7	21.9	23.7
PAT margin	14.5	13.0	14.2	15.6	17.3
Return ratios (%)					
ROE	36.9	35.4	32.4	32.1	31.0
ROCE	20.5	19.9	20.2	22.2	25.0
ROIC	27.6	28.9	30.1	34.0	40.0
Turnover Ratios (days)					
Inventory	96.7	90.0	101.2	100.0	101.7
Debtors	95.4	93.0	101.3	100.0	101.6
Creditors	87.3	98.4	127.7	127.7	127.7
Solvency Ratio (X)					
Debt-equity	1.0	0.7	0.6	0.3	0.1
Net Debt -equity	0.9	0.7	0.5	0.2	0.0
Liquidity ratio	3.4	2.4	2.4	2.1	2.3
Interest coverage	17.1	27.4	31.0	46.9	85.4
Dividend					
DPS Rs.	3.0	4.5	2.5	3.0	3.5
Dividend Yield (%)	0.4	0.6	0.3	0.4	0.5
Dividend Payout (%)	15.0	16.7	7.4	6.6	6.0
Per share (Rs)					
Basic EPS (reported)	40.2	54.0	33.8	45.4	58.7
FDEPS (reported)	20.0	26.9	33.8	45.4	58.7
FDEPS(adjusted)	20.0	26.9	33.8	45.4	58.7
BVPS	128.4	176.6	120.5	162.3	216.9
CEPS	25.4	32.6	40.5	53.4	67.8
Valuation metrics (x)					
P/E	38.5	28.7	22.9	17.0	13.1
P/BV	6.0	4.4	6.4	4.8	3.6
EV/EBIDTA	12.2	10.1	15.1	11.4	9.0
EV/Sales	3.2	2.1	3.5	2.8	2.3

Source: Company, Centrum Research Estimates

Exhibit 10: Balance Sheet

Y/E March (Rs mn)	FY14	FY15	FY16	FY17E	FY18E
Share capital	292	292	585	585	585
Reserves & surplus	37,207	51,266	69,908	94,381	126,289
Total shareholder's fund	37,499	51,558	70,493	94,966	126,874
Loan fund	36,338	38,635	40,762	31,620	17,620
Minority interest	257	258	596	680	750
Deferred tax liability	2,054	2,057	2,365	2,410	2,530
Total capital employed	76,148	92,508	114,216	129,676	147,774
Gross block	37,418	51,071	67,080	77,390	81,200
Accumulated depreciation	(12,297)	(14,708)	(18,034)	(21,292)	(24,977)
Net Block	25,120	36,363	49,046	56,098	56,223
Capital WIP	2,948	2,700	1,200	1,400	2,000
Net fixed assets	28,068	39,063	50,246	57,498	58,223
Deferred tax asset	-	-	-	-	-
Intangible assets	2,246	2,190	2,390	2,620	2,700
Investments	197	197	2	2	2
Cash and bank	1,781	4,688	8,271	12,134	21,576
Inventories	23,676	36,113	40,881	52,700	58,000
Debtors	26,365	35,392	41,719	51,900	58,700
Other current assets and loans and advances	12,560	11,452	13,412	15,260	17,160
Total current assets and loans and advances	64,579	87,842	104,285	131,996	155,438
Current liabilities and provisions	18,745	36,587	42,704	62,438	68,587
Net current assets	45,834	51,255	61,581	69,558	86,851
Total assets	76,148	92,508	114,216	129,676	147,774

Source: Company, Centrum Research Estimates

Exhibit 11: Cash Flow

Y/E March (Rs mn)	FY14	FY15	FY16	FY17E	FY18E
Cash flow from operations					
Net Profit	11,724	15,758	19,747	26,561	34,345
Depreciation and amortization	3,125	3,326	3,926	4,700	5,300
Change in working capital	(14,043)	(2,515)	(6,937)	(4,114)	(7,852)
Deferred tax liability	1,374	3	308	45	120
Foreign Exchange Retranslation Reserve Account	703	(135)	927	(2,109)	(2,109)
Cash flow from operations	2,883	16,437	17,971	25,083	29,804
Cash flow from investments					
Capex	(4,807)	(14,321)	(15,109)	(11,953)	(6,025)
Intangible asset	(58)	56	(200)	(230)	(80)
Minority interest	147	1	338	84	70
Other investing activities	24	0	195	-	-
Cash flow from investments	(4,694)	(14,264)	(14,776)	(12,099)	(6,035)
Cash flow from financing					
Inc / (dec) in long term debt	2,495	2,297	2,127	(9,142)	(14,000)
Dividends paid	(1,042)	(1,564)	(1,740)	(2,088)	(2,437)
Share issuance / (repurchase)	1	-	293	-	-
Cash flow from financing	1,454	733	680	(11,230)	(16,437)
Net Cash Flow	(358)	2,907	3,875	1,754	7,333

Source: Company, Centrum Research Estimates

Appendix A

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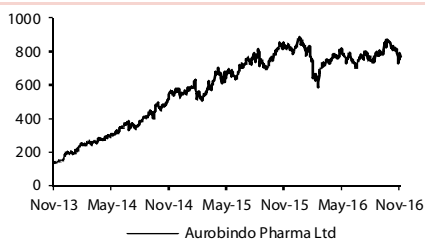
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Aurobindo Pharma price chart



Source: Bloomberg, Centrum Research

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