

February 24, 2020

Event Update

■ Change in Estimates | ■ Target | Reco

Change in Estimates

	Current		Previous	
	FY21E	FY22E	FY21E	FY22E
Rating	SELL		HOLD	
Target Price	525		525	
Sales (Rs. m)	2,38,776	2,53,421	2,38,776	2,53,421
% Chng.	-	-	-	-
EBITDA (Rs. m)	47,158	51,064	47,158	51,064
% Chng.	-	-	-	-
EPS (Rs.)	50.8	53.9	50.8	53.9
% Chng.	-	-	-	-

Key Financials - Consolidated

Y/e Mar	FY19	FY20E	FY21E	FY22E
Sales (Rs. m)	1,92,259	2,24,023	2,38,776	2,53,421
EBITDA (Rs. m)	36,322	42,564	47,158	51,064
Margin (%)	18.9	19.0	19.8	20.2
PAT (Rs. m)	25,819	26,331	29,759	31,565
EPS (Rs.)	44.1	44.9	50.8	53.9
Gr. (%)	3.5	2.0	13.0	6.1
DPS (Rs.)	4.5	4.5	4.5	4.5
Yield (%)	0.8	0.8	0.8	0.8
RoE (%)	20.2	17.5	17.0	15.6
RoCE (%)	16.6	15.0	15.2	14.6
EV/Sales (x)	2.1	1.8	1.6	1.5
EV/EBITDA (x)	11.0	9.3	8.4	7.6
PE (x)	13.6	13.3	11.8	11.1
P/BV (x)	2.5	2.2	1.9	1.6

Key Data

ARBN.BO | ARBP IN

52-W High / Low	Rs.838 / Rs.389
Sensex / Nifty	41,170 / 12,081
Market Cap	Rs.351bn/ \$ 4,895m
Shares Outstanding	586m
3M Avg. Daily Value	Rs.3980.9m

Shareholding Pattern (%)

Promoter's	51.87
Foreign	21.42
Domestic Institution	13.53
Public & Others	13.18
Promoter Pledge (Rs bn)	4.99

Stock Performance (%)

	1M	6M	12M
Absolute	23.9	(0.3)	(17.2)
Relative	25.0	(9.6)	(28.1)

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Downgrade to Sell: Inevitable pain ahead

Quick Pointers:

- Steep task ahead to achieve resolution of Unit IV and VII
- New ANDA filings and approvals to be impacted

USFDA revoked its grant of VAI status to Unit-4 of ARBP two days after its communication on 19th Feb FY20. As per the latest disclosure to the exchanges, the cGMP issue of the manufacturing Unit-4 remains open and is under the review of the regulator. We believe that USFDA may reserve its view on the status of the plant till completion of the ongoing remediation work, guided to be finished by Apr-May FY21E. Nevertheless, FDA may also provisionally offer OAI (Official Action Indicated) for the Unit-4 in near term till satisfactory resolution achieved as we noticed similar track record of FDA in granting OAI status/Warning letter for Unit-1, 9 and 11 of ARBP.

While VAI is marginally easier status for an injectable plant, the only benefits VAI offers v/s OAI are that FDA a) will accept new filings, b) approve new ANDAs from the plant and c) approval process of pending ANDAs to continue as per new FDA (GDUFA) guidelines. We consider the FDA's withdrawal of VAI for Unit-4 is a negative development for ARBP though production/supply of injectable to the US and ANDA filings to continue in near term from the plant. This is expected to have an impact on the filings of complex injectable and lower volume of exports from Unit-4 due to ongoing remediation works. Given its USP of approvals and launching of a large number of generics, the slower rate of filings from Unit-4 and Unit-7 to impact earnings in the medium term due to high uncertainty over launches key generics from the plants.

We downgrade ARBP to 'Sell' (earlier Hold) and retain TP of Rs525 (PE 10x of FY22E). We believe that complete resolution of Unit -1, 4, 7, 9, 11 would be a difficult to achieve in near term. Being a large API plant, the Unit-11 is key for maintaining lower COGS for many current and future ANDAs of highly genericized molecules. The Unit-4 and Unit-7 are the two largest US contributors in injectable and oral drugs respectively. Hence, the high uncertainty over the three key plants to impact valuation of ARBP till positive outcome from its remediation works are achieved.

- Other key concerning issues in the company:** In FY19, US sales were US\$1,292mn (46% of the total revenue), while injectable business clocked revenue of US\$213mn (16.5% of US revenue) with high EBITDA margin profile of 50-70%. The Unit-4 and 7 combined contributions was 44% of US revenues and 42% of pending ANDAs. Whilst Unit-4 is the major growth driver of US sales as 80% of US injectable are filed from this facility. With track record since FY15 onwards, FDA generally awarded resolution on an injectable only after 18-24 months (approx.) of remediation work and in few instances it took even 5 years. Unit-4 being an injectable plant, there is a likely possibility of lingering process in achieving complete resolution in FY20E and 21E for injectable unit and this would hinder growth for high margin products in US.



Exhibit 1: Aurobindo ANDA's and inspection details

Plant	Current USFDA Status	Inspection Date	ANDA Status
Unit I-API	OAI	02-02-2019	
Unit IV-Injectable	14 Observations	13-11-2019	46 under review and 65 approved
Unit VII-Oral	7 Observations	27-09-2019	18 under review and 135 approved
Unit IX-Intermediates	OAI	02-02-2019	
Unit XI-API	Warning Letter	09-02-2019	WL Impacted ~15 products

Source: Company, PL

Exhibit 2: Resolution of WL has always been a long and painful journey

	Date of WL	Date of Resolution
Sunpharma Halol (Halol Unit)	09-Dec-15	12-Jun-18
Cadila (Moraiya unit)	05-Sep-14	08-Jul-16
DRL (plant in Duvvada)	05-Nov-15	17-Feb-19
Lupin (Goa & Indore)	16-Nov-17	No Resolution Yet
Mylan Labs (Nashik)	08-Jun-15	13-Aug-18

Source: Company, PL

Financials

Income Statement (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
Net Revenues	1,92,259	2,24,023	2,38,776	2,53,421
YoY gr. (%)	18.4	16.5	6.6	6.1
Cost of Goods Sold	86,948	99,690	1,08,643	1,14,673
Gross Profit	1,05,311	1,24,333	1,30,133	1,38,748
Margin (%)	54.8	55.5	54.5	54.8
Employee Cost	25,849	29,123	26,862	28,130
Other Expenses	8,716	13,441	14,327	15,205
EBITDA	36,322	42,564	47,158	51,064
YoY gr. (%)	3.5	17.2	10.8	8.3
Margin (%)	18.9	19.0	19.8	20.2
Depreciation and Amortization	5,685	10,047	10,999	12,874
EBIT	30,636	32,517	36,159	38,191
Margin (%)	15.9	14.5	15.1	15.1
Net Interest	1,627	1,660	1,524	1,447
Other Income	4,929	5,225	5,539	5,871
Profit Before Tax	33,939	36,083	40,174	42,614
Margin (%)	17.7	16.1	16.8	16.8
Total Tax	7,269	9,381	10,445	11,080
Effective tax rate (%)	21.4	26.0	26.0	26.0
Profit after tax	26,671	26,701	29,729	31,535
Minority interest	(29)	(30)	(30)	(30)
Share Profit from Associate	-	-	-	-
Adjusted PAT	25,819	26,331	29,759	31,565
YoY gr. (%)	3.5	2.0	13.0	6.1
Margin (%)	13.4	11.8	12.5	12.5
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	25,819	26,331	29,759	31,565
YoY gr. (%)	3.5	2.0	13.0	6.1
Margin (%)	13.4	11.8	12.5	12.5
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	25,819	26,331	29,759	31,565
Equity Shares O/s (m)	586	586	586	586
EPS (Rs)	44.1	44.9	50.8	53.9

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
Non-Current Assets				
Gross Block	96,651	1,22,336	1,39,999	1,58,028
Tangibles	74,283	95,703	1,09,003	1,22,568
Intangibles	22,368	26,633	30,996	35,460
Acc: Dep / Amortization	20,228	30,275	41,274	54,147
Tangibles	17,347	24,722	33,176	43,040
Intangibles	2,881	5,553	8,097	11,107
Net fixed assets	76,423	92,061	98,725	1,03,881
Tangibles	56,937	70,981	75,826	79,528
Intangibles	19,487	21,080	22,899	24,353
Capital Work In Progress	16,685	8,663	9,029	9,411
Goodwill	8,325	8,325	8,325	8,325
Non-Current Investments	4,572	4,815	5,118	5,497
Net Deferred tax assets	(980)	(66)	(869)	(1,722)
Other Non-Current Assets	3,060	3,573	4,190	4,932
Current Assets				
Investments	0	0	0	0
Inventories	72,456	78,057	85,220	91,555
Trade receivables	34,138	38,667	40,559	43,047
Cash & Bank Balance	19,572	17,688	17,894	21,728
Other Current Assets	13,742	16,491	19,789	23,746
Total Assets	2,64,544	2,83,890	3,04,337	3,27,540
Equity				
Equity Share Capital	586	586	586	586
Other Equity	1,38,322	1,61,090	1,87,764	2,16,244
Total Network	1,38,908	1,61,675	1,88,350	2,16,830
Non-Current Liabilities				
Long Term borrowings	1,800	1,710	1,624	1,543
Provisions	465	582	588	593
Other non current liabilities	113	-	-	-
Current Liabilities				
ST Debt / Current of LT Debt	65,732	62,445	59,323	56,357
Trade payables	26,771	29,461	32,055	33,327
Other current liabilities	27,926	18,848	13,110	9,480
Total Equity & Liabilities	2,64,544	2,75,883	2,96,182	3,19,232

Source: Company Data, PL Research

Cash Flow (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
PBT	32,767	36,083	40,174	42,614
Add. Depreciation	6,680	10,047	10,999	12,874
Add. Interest	1,627	1,660	1,524	1,447
Less Financial Other Income	4,929	5,225	5,539	5,871
Add. Other	(2,051)	4,314	(1,022)	(1,180)
Op. profit before WC changes	39,021	52,103	51,675	55,756
Net Changes-WC	(15,103)	(19,877)	(16,211)	(15,941)
Direct tax	(7,698)	(8,660)	(9,642)	(10,227)
Net cash from Op. activities	16,220	23,566	25,822	29,588
Capital expenditures	(28,568)	(17,663)	(18,029)	(18,411)
Interest / Dividend Income	263	268	273	279
Others	(463)	-	-	-
Net Cash from Invt. activities	(28,768)	(17,395)	(17,756)	(18,132)
Issue of share cap. / premium	1	-	-	-
Debt changes	22,304	(3,377)	(3,208)	(3,047)
Dividend paid	(1,599)	(3,085)	(3,085)	(3,085)
Interest paid	(1,515)	(1,660)	(1,524)	(1,447)
Others	-	-	-	-
Net cash from Fin. activities	19,191	(8,121)	(7,816)	(7,580)
Net change in cash	6,643	(1,950)	251	3,876
Free Cash Flow	(12,348)	5,903	7,793	11,176

Source: Company Data, PL Research

Quarterly Financials (Rs m)

Y/e Mar	Q4FY19	Q1FY20	Q2FY20	Q3FY20
Net Revenue	52,020	53,568	55,183	57,994
YoY gr. (%)	30.4	28.1	18.2	12.1
Raw Material Expenses	23,726	22,985	23,683	25,650
Gross Profit	28,294	30,583	31,500	32,344
Margin (%)	54.4	57.1	57.1	55.8
EBITDA	9,701	10,586	10,853	11,125
YoY gr. (%)	30.5	49.0	15.2	12.1
Margin (%)	18.6	19.8	19.7	19.2
Depreciation / Depletion	1,866	2,409	2,433	2,501
EBIT	7,835	8,178	8,419	8,624
Margin (%)	15.1	15.3	15.3	14.9
Net Interest	501	499	409	371
Other Income	1,197	1,035	756	1,265
Profit before Tax	8,530	8,714	8,766	9,517
Margin (%)	16.4	16.3	15.9	16.4
Total Tax	2,311	2,278	2,244	2,329
Effective tax rate (%)	27.1	26.1	25.6	24.5
Profit after Tax	6,219	6,437	6,522	7,189
Minority interest	4	(49)	(1)	(1)
Share Profit from Associates	-	-	-	-
Adjusted PAT	6,216	6,485	6,523	7,190
YoY gr. (%)	17.6	42.3	2.2	(2.5)
Margin (%)	11.9	12.1	11.8	12.4
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	6,216	6,485	6,523	7,190
YoY gr. (%)	17.6	42.3	2.2	(2.5)
Margin (%)	11.9	12.1	11.8	12.4
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	6,216	6,485	6,523	7,190
Avg. Shares O/s (m)	586	586	586	586
EPS (Rs)	10.6	11.1	11.1	12.3

Source: Company Data, PL Research

Key Financial Metrics

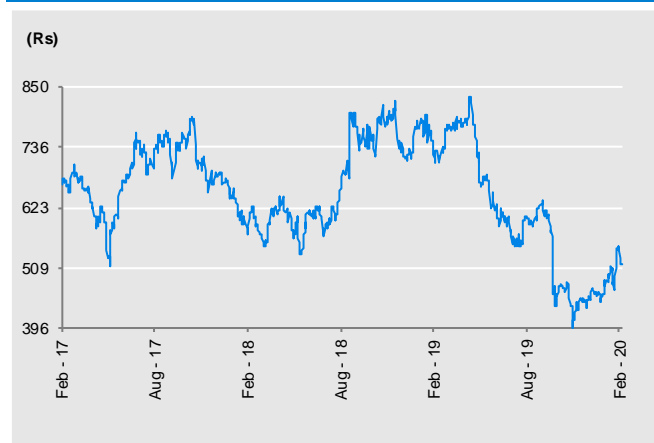
Y/e Mar	FY19	FY20E	FY21E	FY22E
Per Share(Rs)				
EPS	44.1	44.9	50.8	53.9
CEPS	53.8	62.1	69.6	75.8
BVPS	237.1	275.9	321.5	370.1
FCF	(21.1)	10.1	13.3	19.1
DPS	4.5	4.5	4.5	4.5
Return Ratio(%)				
RoCE	16.6	15.0	15.2	14.6
ROIC	12.5	12.2	12.6	12.5
RoE	20.2	17.5	17.0	15.6
Balance Sheet				
Net Debt : Equity (x)	0.3	0.3	0.2	0.2
Net Working Capital (Days)	152	142	143	146
Valuation(x)				
PER	13.6	13.3	11.8	11.1
P/B	2.5	2.2	1.9	1.6
P/CEPS	11.1	9.6	8.6	7.9
EV/EBITDA	11.0	9.3	8.4	7.6
EV/Sales	2.1	1.8	1.6	1.5
Dividend Yield (%)	0.8	0.8	0.8	0.8

Source: Company Data, PL Research

Key Operating Metrics

Y/e Mar	FY19	FY20E	FY21E	FY22E
US Formulations	90,307	1,12,374	1,18,295	1,25,610
EU & ROW	61,539	67,611	73,848	78,403
ARV formulations	9,725	12,045	13,008	14,049
APIs	34,030	31,536	33,141	34,849

Source: Company Data, PL Research

Price Chart
Recommendation History


No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	07-Feb-20	Hold	525	547
2	03-Jan-20	Hold	412	460
3	13-Nov-19	Hold	511	434
4	09-Oct-19	Hold	511	452
5	03-Oct-19	BUY	715	580
6	08-Aug-19	BUY	715	600
7	04-Jul-19	BUY	932	605
8	05-Apr-19	BUY	952	787
9	04-Apr-19	BUY	952	773
10	20-Mar-19	BUY	952	777

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Aurobindo Pharma	Hold	525	547
2	Cadila Healthcare	Hold	247	272
3	Cipla	Reduce	460	448
4	Dr. Lal PathLabs	Hold	1,797	1,741
5	Dr. Reddy's Laboratories	Accumulate	3,331	3,200
6	Eris Lifesciences	Accumulate	522	467
7	Glenmark Pharmaceuticals	Reduce	325	310
8	Indoco Remedies	Hold	198	234
9	Ipca Laboratories	BUY	1,826	1,423
10	Jubilant Life Sciences	Reduce	488	583
11	Lupin	Reduce	654	722
12	Sun Pharmaceutical Industries	Reduce	412	431
13	Thyrocare Technologies	BUY	724	603

PL's Recommendation Nomenclature (Absolute Performance)

Buy	: > 15%
Accumulate	: 5% to 15%
Hold	: +5% to -5%
Reduce	: -5% to -15%
Sell	: < -15%
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly



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