

Aurobindo Pharma

22 April 2020

Reuters: ARBP.NS; Bloomberg: ARBP IN

Unit IV classified VAI – overhang on the stock removed

Aurobindo Pharma Ltd (APL) has received an EIR for its Unit-IV and the status is classified as VAI. The VAI status puts to rest concerns about the compliance woes at the facility getting aggravated. The stock price reaction (up 19%) was an outcome of valuation rerating and a potential higher earnings growth trajectory. We revise our FY21/FY22 EPS estimates from Rs43.3/Rs44.0 to Rs45.3/Rs47.9, respectively.

The VAI removes overhang on the stock: Unit IV is one of the most critical plants from an organic growth perspective and hence the stock was trading at depressed multiples post getting form 483 observations in November 2019. These observations were perceived to be critical and hence a delayed resolution was envisaged. The caution level was even higher than justified by the potential future contribution from the plant as APL's compliance woes were not limited to Unit IV but spread across its manufacturing network.

While Unit IV and Unit VIII have recently received EIR, APL continues to face an OAI status / warning letter at four other manufacturing units which include - Unit I, Unit VII, Unit IX and Unit XI. However, clearance of Unit IV is the most critical and important as the plant is sterile in nature and attracts very high level of scrutiny. In the past, we have seen companies taking 3 – 4 years in successfully addressing compliance at sterile facilities.

Impact of Unit IV clearance on earnings growth forecasts: About 46 ANDA approvals are pending from Unit IV, which comprises about 30% of the company's ANDA pipeline awaiting approval. APL's relative dependence on Unit IV for future growth is high. Since the facility is a sterile one, the approvals are expected to generate higher margins compared to the base business margins. We anticipate approvals to start coming in now and add about US\$20mn to annual revenue and about 5-10% to our existing EPS estimates.

We revise our FY21/FY22 EPS estimates for APL from Rs43.3/Rs44.0 to Rs45.3/Rs47.9, respectively. Considering the ongoing favorable progress in resolving compliance situation, we revise our target PE multiple from 11x to 15x and revise our target price to Rs719 (from Rs484 earlier) while revising our rating to Accumulate (from Buy earlier).

Key positive and negative triggers going forward for APL stock price are as follows:

- 1) An overall improvement in pricing situation in regulated markets arising out of a need to do supply chain diversification – we currently do not assume any upside from the same.
- 2) Improvement in margins in the European Business – we model a 200bps improvement in European business margins driven by a turnaround in Apotex operations.
- 3) Reducing net debt levels further, which in turn should help in rerating and open APL for inorganic initiatives.
- 4) R&D spend expansion – APL needs to invest in clinical trials for complex injectables, biosimilars and other complex generics, which might lead to a temporary surge in R&D spend and depress near term earnings.
- 5) US has reduced funding for WHO, which can adversely impact tender business for APL.

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net sales	164,998	195,636	229,135	235,167	243,826
EBITDA	37,885	39,519	47,095	47,259	47,973
Net profit	24,198	23,618	26,989	26,485	28,047
EPS (Rs)	41.4	40.4	44.8	45.3	47.9
EPS growth (%)	5.3	(2.4)	11.1	1.0	5.9
EBITDA margin (%)	23.0	20.2	20.6	20.1	19.7
PER (x)	14.3	19.6	14.4	14.2	13.4
P/BV (x)	3.0	3.3	2.3	2.0	1.8
EV/EBITDA (x)	9.0	11.3	8.0	7.5	6.8
RoCE (%)	28.1	21.0	23.0	20.1	18.6
RoE (%)	20.7	17.0	16.5	14.1	13.1

Source: Company, Nirmal Bang Institutional Equities Research

ACCUMULATE

Sector: Pharmaceuticals

CMP: Rs644

Target Price: Rs719

Upside: 12%

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Key Data

Current Shares O/S (mn)	585.9
Mkt Cap (Rsbn/US\$bn)	377.6/4.9
52 Wk H / L (Rs)	838/281
Daily Vol. (3M NSE Avg.)	7,632,868

Price Performance (%)

	1 M	6 M	1 Yr
Aurobindo Pharma	85.9	35.0	(17.4)
Nifty Index	2.7	(22.5)	(22.5)

Source: Bloomberg

Exhibit 1: Change in our estimates

(Rsmn)	New estimates			Old estimates			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Net sales	229,135	235,167	243,826	229,135	233,667	240,858	0.0	0.6	1.2
EBITDA	47,095	47,259	47,973	47,095	45,759	45,005	0.0	3.3	6.6
Margin (%)	20.6	20.1	19.7	20.6	19.6	18.7	0 bps	51 bps	99 bps
PAT	26,989	26,485	28,047	26,989	25,360	25,755	0.0	4.4	8.9
Margin (%)	11.8	11.3	11.5	11.8	10.9	10.7	0 bps	41 bps	81 bps
EPS	44.8	45.3	47.9	44.8	43.3	44.0	0.0	4.4	8.9

Source: Company, Nirmal Bang Institutional Equities Research

Financial statement
Exhibit 2: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net sales	164,998	195,636	229,135	235,167	243,826
% growth	9.3	18.6	17.1	2.6	3.7
Raw material costs	67,527	87,126	98,602	101,305	104,597
Staff costs	21,308	25,849	31,846	32,297	34,235
R&D expenses	6,665	8,716	9,760	12,736	13,212
Other expenditure	31,612	34,425	41,833	41,571	43,810
Total expenditure	127,113	156,116	182,040	187,908	195,854
EBITDA	37,885	39,519	47,095	47,259	47,973
% growth	10.3	4.3	19.2	0.3	1.5
EBITDA margin (%)	23.0	20.2	20.6	20.1	19.7
Other income	1,020	1,157	756	111	2,058
Interest costs	777	1,627	1,651	1,949	2,009
Gross profit	97,471	108,509	130,533	133,863	139,229
% growth	12.6	11.3	20.3	2.6	4.0
Depreciation	5,580	6,680	9,844	10,182	10,704
Profit before tax	32,381	31,767	35,719	35,239	37,317
% growth	6.0	(1.9)	12.4	(1.3)	5.9
Tax	8,183	7,269	9,113	8,754	9,270
Effective tax rate (%)	25.3	22.9	25.5	24.8	24.8
Share of MI and associates	34.0	2.3	4.7	0.0	0.0
PAT after share of MI & associates	24,232	23,620	26,994	26,485	28,047
% growth	5.4	(2.4)	14.3	(1.9)	5.9
EPS (Rs)	41.4	40.4	44.8	45.3	47.9
% growth	5.3	(2.4)	11.1	1.0	5.9

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Balance sheet

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Equity	586	586	586	586	586
Reserves	116,218	138,322	162,824	187,585	213,909
Net worth	116,804	138,908	163,410	188,171	214,494
Minority Interest	18	16	16	16	16
Net deferred tax liabilities	2,353	2,813	2,813	2,813	2,813
Total Loans	44,825	67,532	59,499	60,911	62,794
Other Non-Current Liabilities	559	578	578	578	578
Liabilities	164,560	209,847	226,316	252,489	280,696
Net Block	47,366	56,937	74,511	78,328	81,626
CWIP	13,995	13,419	19,415	15,415	11,414
Intangible Assets & Goodwill	19,676	31,077	31,077	31,077	31,077
Other Non-Current Assets	8,136	9,454	9,454	9,454	9,454
Inventories	58,584	72,456	85,543	87,888	90,744
Debtors	30,844	34,150	42,851	43,997	45,643
Cash	12,616	19,572	1,458	26,050	52,712
Other current assets	19,835	27,480	27,480	27,480	27,480
Total current assets	121,879	153,657	157,332	185,415	216,578
Creditors	26,274	26,771	38,365	39,417	40,698
Other current liabilities	20,218	27,926	27,107	27,783	28,755
Total current liabilities	46,492	54,697	65,472	67,200	69,453
Net current assets	75,386	98,960	91,860	118,215	147,126
Total assets	164,560	209,847	226,316	252,489	280,696

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Cash flow

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
EBIT	33,189	32,540	37,021	37,223	39,362
(Inc.)/dec. in working capital	(12,872)	(16,618)	(11,014)	(1,763)	(2,249)
Cash flow from operations	20,318	15,922	26,007	35,460	37,113
Other income	(1,020)	(1,157)	(756)	(111)	(2,058)
Other expenses	1,860	1,341	(384)	0	0
Depreciation	5,580	6,680	9,844	10,182	10,704
Tax paid (-)	(8,183)	(7,269)	(9,113)	(8,754)	(9,270)
Net cash from operations	18,554	15,517	25,598	36,777	36,488
Capital expenditure (-)	(23,698)	(27,076)	(33,414)	(10,000)	(10,000)
Net cash after capex	(5,144)	(11,558)	(7,816)	26,777	26,488
Other investment activities	398	(161)	756	111	2,058
Cash from financial activities	12,228	18,675	(11,054)	(2,296)	(1,885)
Opening cash balance	5,135	12,616	19,572	1,458	26,050
Closing cash balance	12,616	19,572	1,458	26,050	52,712
Change in cash balance	7,482	6,956	(18,114)	24,592	26,661

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Key ratios

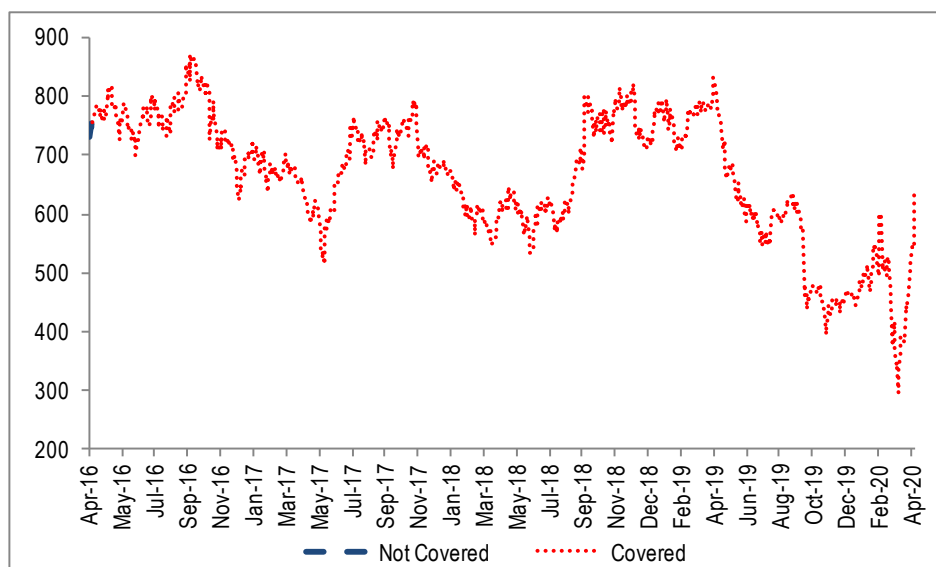
Y/E March	FY18	FY19	FY20E	FY21E	FY22E
Profitability & return ratios					
EBITDA margin (%)	23.0	20.2	20.6	20.1	19.7
EBIT margin (%)	20.1	16.6	16.2	15.8	16.1
Net profit margin (%)	14.7	12.1	11.8	11.3	11.5
RoE (%)	20.7	17.0	16.5	14.1	13.1
RoCE (%)	28.1	21.0	23.0	20.1	18.6
Working capital & liquidity ratios					
Receivables (days)	65	61	61	67	67
Inventory (days)	275	274	292	312	312
Payables (days)	129	111	121	140	140
Current ratio (x)	2.6	2.8	2.4	2.8	3.1
Quick ratio (x)	1.4	1.5	1.1	1.5	1.8
Valuation ratios					
EV/sales (x)	2.1	2.3	1.6	1.5	1.3
EV/EBITDA (x)	9.0	11.3	8.0	7.5	6.8
P/E (x)	14.3	19.6	14.4	14.2	13.4
P/BV (x)	3.0	3.3	2.3	2.0	1.8

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
7 April 2016	Buy	746	894
31 May 2016	Buy	754	900
24 August 2016	Buy	737	900
17 November 2016	Buy	714	920
10 February 2017	Buy	679	920
31 May 2017	Buy	580	704
29 June 2017	Accumulate	675	704
19 July 2017	Accumulate	778	819
10 August 2017	Buy	685	819
10 November 2017	Accumulate	789	818
8 February 2017	Buy	616	792
13 August 2018	Buy	610	764
13 November 2018	Accumulate	775	864
11 February 2019	Accumulate	761	866
5 April 2019	Accumulate	782	867
30 May 2019	Buy	692	868
8 August 2019	Buy	555	868
23 September 2019	Buy	619	876
9 October 2019	Buy	474	761
14 November 2019	Buy	438	756
10 February 2020	Buy	542	756
2 April 2020	Buy	392	484
22 April 2020	Accumulate	644	719

Rating track graph



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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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