AUROBINDO PHARMA

RESULT UPDATE

KEY DATA

Rating	BUY
Sector relative	Outperformer
Price (INR)	672
12 month price target (INR)	950
Market cap (INR bn/USD bn)	394/5.3
Free float/Foreign ownership (%)	48.2/23.7

What's Changed

Target Price	↓
Rating/Risk Rating	–

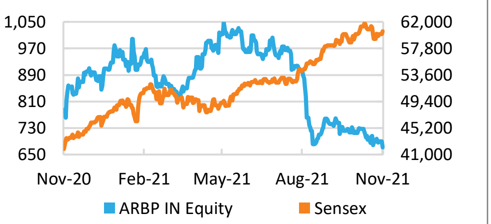
QUICK TAKE

	Above	In line	Below
Profit			•
Margins			•
Revenue Growth			•
Overall			•

FINANCIALS (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Revenue	2,47,747	2,40,678	2,59,450	2,92,765
EBITDA	53,335	49,963	59,267	73,903
Adjusted profit	32,250	30,427	35,707	45,737
Diluted EPS (INR)	55.0	51.9	60.9	78.0
EPS growth (%)	12.6	(5.7)	17.4	28.1
RoAE (%)	27.5	13.0	13.5	15.1
P/E (x)	12.2	12.9	11.0	8.6
EV/EBITDA (x)	7.3	7.8	6.3	4.6
Dividend yield (%)	0.6	0.5	0.5	0.7

PRICE PERFORMANCE



Explore:

Financial model

Podcast

Corporate access

Video

Margins slip; growth levers aplenty

Aurobindo Pharma (ARBP) undershot revenue/EBITDA by 4%/9% due to weak ARVs (-71% YoY) and APIs (-4% YoY). The US was surprisingly strong (+7% YoY). Rising input costs hit gross margin (-340bps YoY); meanwhile, opex control limited the decline in EBITDA margin to 20%.

We believe risk-reward remains favourable as: i) barring near-term pressure, the US pipeline looks solid; ii) injectable expansion is margin-accretive; iii) biosimilars would aid growth post-FY23; iv) gRevlimid provides earning visibility over FY23–25; and v) 250+ EU pipeline can drive steady growth of 9–10%. We are cutting FY22/23E EPS by 9%/3% owing to near-term input cost-related concerns. On balance, we retain 'BUY' with a TP of INR950 (from INR990) including INR25 for gRevlimid.

Q2FY22 takeaways: Soft APIs and ARVs; rising input costs hit margins

Revenue at INR59.4bn declined 2% YoY with APIs and ARVs missing expectations. The US (USD401mn; +7% YoY/+11% QoQ) was stronger despite high single-digit price erosion and elevated channel inventory. Generic injectables (USD68mn, +10% QoQ), while still behind its peak, is improving on account of a gradual recovery in hospital channels. Gross margin dipped 340bps YoY, mainly on account of rising input costs. But opex control ensured decline of only 210bps YoY in EBITDA margin to 20%.

Near-term hurdles, but enough catalysts to drive growth

The near-term pressure from ertapenem competition and high-single-digit price erosion are likely to be offset by a pipeline of ~170 pending ANDAs, 50 annual launches and gRevlimid settlement. ARBP has a clear focus on growing injectables, and its target to achieve USD650–700mn in sales over the next three years remains intact. ARBP is also on the cusp of filing biosimilars, nasals, inhalers, transdermals, and depot injections. While it entails high R&D outlay and execution risks, we see limited risk to our mid-single-digit US growth estimates given low profit concentration. On our conservative assumptions, biosimilars can add INR60/share to fair value and the vaccine opportunity implies further upside to FY23/24E. That management is pushing all areas to improve EU profitability is promising too.

Outlook and valuation: Risk-reward turning favourable; retain 'BUY'

ARBP's business is steady and low-profit concentration. The biosimilars and injectables expansion provides an additional push to high US base. gRevlimid settlement offers cushion for its complex generics business. Our TP of INR950 is based on 16x FY23E core EPS and INR25/share from gRevlimid. Maintain **'BUY/SO'**.

Financials

Year to March	Q2FY22	Q2FY21	% Change	Q1FY22	% Change
Net Revenue	59,419	64,834	(8.4)	57,020	4.2
EBITDA	11,867	14,328	(17.2)	12,094	(1.9)
Adjusted Profit	6,956	8,017	(13.2)	7,485	(7.1)
Diluted EPS (INR)	11.9	13.7	(13.2)	12.8	(7.1)

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Financial Statements

Income Statement (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Total operating income	2,47,747	2,40,678	2,59,450	2,92,765
Gross profit	1,48,722	1,40,556	1,57,486	1,81,368
Employee costs	35,350	34,997	38,286	41,885
R&D cost	15,095	15,403	16,605	18,151
Other expenses	44,942	40,193	43,328	47,428
EBITDA	53,335	49,963	59,267	73,903
Depreciation	10,554	11,686	13,256	15,046
Less: Interest expense	745	555	490	425
Add: Other income	2,773	3,268	2,522	2,984
Profit before tax	44,255	40,549	47,602	60,976
Prov for tax	20,098	10,137	11,901	15,244
Less: Exceptional item	28,146	0	0	0
Reported profit	53,349	30,427	35,707	45,737
Adjusted profit	32,250	30,427	35,707	45,737
Diluted shares o/s	586	586	586	586
Adjusted diluted EPS	55.0	51.9	60.9	78.0
DPS (INR)	4.0	3.1	3.7	4.7
Tax rate (%)	45.4	25.0	25.0	25.0

Balance Sheet (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Share capital	586	586	586	586
Reserves	2,18,713	2,47,150	2,80,500	3,23,218
Shareholders funds	2,19,299	2,47,735	2,81,085	3,23,804
Minority interest	(9)	(24)	(29)	(34)
Borrowings	49,711	42,711	37,711	32,711
Trade payables	27,947	26,174	26,655	27,468
Other liabs & prov	31,896	33,979	36,534	41,068
Total liabilities	3,34,013	3,55,744	3,87,126	4,30,186
Net block	89,447	1,14,761	1,29,505	1,34,458
Intangible assets	4,289	4,289	4,289	4,289
Capital WIP	30,615	30,615	30,615	30,615
Total fixed assets	1,24,351	1,49,665	1,64,409	1,69,363
Non current inv	4,312	4,312	4,312	4,312
Cash/cash equivalent	56,341	46,702	59,673	83,893
Sundry debtors	35,033	44,962	48,469	52,136
Loans & advances	216	216	216	216
Other assets	1,06,718	1,02,845	1,03,005	1,13,224
Total assets	3,34,013	3,55,744	3,87,126	4,30,186

Important Ratios (%)

Year to March	FY21A	FY22E	FY23E	FY24E
Gross margin	60.0	58.4	60.7	62.0
R&D as a % of sales	6.1	6.4	6.4	6.2
Net Debt/EBITDA	(0.1)	(0.1)	(0.4)	(0.7)
EBITDA margin (%)	21.5	20.8	22.8	25.2
Net profit margin (%)	13.0	12.6	13.8	15.6
Revenue growth (% YoY)	7.3	(2.9)	7.8	12.8
EBITDA growth (% YoY)	10.5	(6.3)	18.6	24.7
Adj. profit growth (%)	12.7	(5.7)	17.4	28.1

Free Cash Flow (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Reported profit	53,349	30,427	35,707	45,737
Add: Depreciation	10,554	11,686	13,256	15,046
Interest (net of tax)	745	555	490	425
Others	(20,691)	0	0	0
Less: Changes in WC	(10,668)	(5,747)	(630)	(8,539)
Operating cash flow	33,289	36,921	48,823	52,669
Less: Capex	10,741	(37,000)	(28,000)	(20,000)
Free cash flow	44,030	(79)	20,823	32,669

Assumptions (%)

Year to March	FY21A	FY22E	FY23E	FY24E
GDP (YoY %)	5.0	7.0	6.0	6.0
Repo rate (%)	4.0	3.5	4.0	4.0
USD/INR (average)	74.0	73.0	72.0	72.0
US generics (USD mn)	1,666.0	1,548.4	1,684.4	1,998.9
API (USD mn)	417.0	442.3	486.9	520.6
Europe growth (%)	(4.9)	11.0	10.0	8.0
ROW growth (%)	6.1	10.0	10.0	10.0
ARV growth (%)	48.8	(45.0)	14.0	5.0
Capex (USD mn)	246.7	500.0	388.9	0

Key Ratios

Year to March	FY21A	FY22E	FY23E	FY24E
RoE (%)	27.5	13.0	13.5	15.1
RoCE (%)	18.5	14.9	15.9	18.3
Inventory days	308	320	302	287
Receivable days	58	61	66	63
Payable days	98	99	95	89
Working cap (% sales)	33.6	37.0	34.6	33.6
Gross debt/equity (x)	0.2	0.2	0.1	0.1
Net debt/equity (x)	0	0	(0.1)	(0.2)
Interest coverage (x)	57.4	68.9	93.9	138.4

Valuation Metrics

Year to March	FY21A	FY22E	FY23E	FY24E
Diluted P/E (x)	12.2	12.9	11.0	8.6
Price/BV (x)	1.8	1.6	1.4	1.2
EV/EBITDA (x)	7.3	7.8	6.3	4.6
Dividend yield (%)	0.6	0.5	0.5	0.7

Source: Company and Edelweiss estimates

Valuation Drivers

Year to March	FY21A	FY22E	FY23E	FY24E
EPS growth (%)	12.6	(5.7)	17.4	28.1
RoE (%)	27.5	13.0	13.5	15.1
EBITDA growth (%)	10.5	(6.3)	18.6	24.7
Payout ratio (%)	4.4	6.0	6.0	6.0

Q2FY22 conference call: Key highlights

Financials/Others

- Margin- significant cost pressure on solvent pricing, power, etc. But there is room for cost rationalisation.
- Capex: normal capex of USD122mn in H1FY22 and USD60mn in Q2FY22. Would spend USD200mn in FY22. FY23 should be similar trajectory. Not expecting incremental capex except acquisitions of ANDA and brands and PLI projects which would be over and above. Not looking at large ticket acquisitions.
- Capital allocation- committed to return more to shareholders.
- Receivables days have down QoQ. Unlikely to see a major change.
- Succession plan – Board meeting is in early December.
- USD/INR 73.94 for Sep'21

Segments

- ARV declined 70% due to high base in the last quarter. Already submitted bid in South Africa and procurement will happen 9 months from now. Its more to do with inventory with the players leading to aggressive price erosion.
- US : old solids registering good volumes on the back of shortages and shortfalls in previous quarter. That said, price erosion is high single digit but expect it to stabilise in 1-2 quarters. Stock adjustments will also be there which will have double effect.
- USD9mn contribution from OTC brands acquired. Yearly run-rate is around USD35-38mn. This is branded business whereas Natrol was regular brands. There are 1-2 products which are common.
- Generic injectables at USD68mn (still behind their peak sales of USD 75mn pre-covid). Target of global injectable of achieving 600-700mn remain intact.
- Want to wait for 1 more quarter before confirming USD400mn as the base for US business. Cautious stance is on account of inventory with the other players who are looking to liquidate. Plus nearing year end.
- Global injectable sales for the quarter- USD105mn (USD102mn in Jun'21). Achieved USD395mn in FY21.
- Respiratory: 6 MDI and 2 DPI (partner agreement). DPI work ongoing with partners. 1st MDI already filed. Received queries from USFDA which the company answered 2 weeks back. 2nd MDI product will be filed in first quarter of next FY. Pk studies ongoing. FDA inspection may happen in next 1-2 months and approval in next FY. Expect to file 3rd MDI product by the end of next year.
- Biosimilars- second oncology product successfully completed phase 3 trial. Filing in FY22. Another would be filed in next FY.
- Depo injections – Expect to file 1-2 products in FY23.
- Regulatory- Responded to queries on Unit 1. Aurolife oral plant USFDA inspection ongoing.

- PLI- discussion ongoing with government. Should get clarity by end of this year before committing larger capex.
- Filing in China- 28 products (3-4 products in Q2FY22) of which 2 products are approved. 1 got it tender bit. Expecting another 5-6 products in next 3-6 months.
- Europe: margin touching low teens despite Apotex loss making. 1) Eugia has 55 products of which 12 are filed, 9 launched and another 9 will be launched in next 3 quarters. 2) Vizag facility- 50 generic injectables- 12 already approved from Unit 4. 3) Penem block expanded (not able to fully supply meropenem). Unutilised capacity from penem block would also be used. Reactivated Cephalosporin.

Vaccines and covid

- Bacterial- Pneumococcal vaccine phase 3 ongoing. Launch expected in Q3FY23 in India. Would add 1-2 more products. WHO filing after 6 months. Facility needs to be inspected by WHO.
- Viral- supporting clinical batches.
- Covid: Vaccine product did not go well.
- Molnupiravir: awaiting DCGI approval. SEC meeting scheduled on November 30th. Already ready with the product.

Exhibit 1: Segmental information (INR mn)

Year to March	Q2FY22	Q2FY21	% change	Q1FY22	% change	Q2FY22E	Deviation (%)
Total Fomulations	51,612	56,538	(8.7)	48,898	5.6	52,772	(2.2)
US	29,676	31,898	(7.0)	26,812	10.7	27,380	8.4
Europe	16,623	15,148	9.7	15,829	5.0	16,663	(0.2)
ROW	3,863	4,465	(13.5)	3,293	17.3	3,929	(1.7)
ARV	1,450	5,027	(71.2)	2,964	(51.1)	4,800	(69.8)
Total API	7,806	8,290	(5.8)	8,119	(3.9)	8,000	(2.4)
SSPs+ Cephs	4,208	4,344	(3.1)	3,836	9.7	4,200	0.2
ARV and others	3,598	3,946	(8.8)	4,283	(16.0)	3,800	(5.3)
Total gross sales	59,418	64,828	(8.3)	57,017	4.2	60,772	(2.2)
Milestone income	0	6	(100.0)	2	-	10	
Total gross sales (incl milestone)	59,418	64,834	(8.4)	57,019	4.2	60,782	(2.2)
	Q2FY22	Q2FY21	% change	Q1FY22	% change		
Oral solids (USD mn)	288	272	5.9	255	13.0		
Injectables (Auromedics)	68	64	6.0	62	10.1		

Source: Company, Edelweiss Research

Exhibit 2: Actuals versus estimates (INR mn)

Year to March	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	Edel estimate	Deviation (%)
Net revenues	59,419	64,834	(8.4)	57,020	4.2	60,982	(2.6)
Gross profit	34,363	39,677	(13.4)	33,358	3.0	35,857	(4.2)
Gross margin(%)	57.8	61.2		58.5		58.8	(96.8)
Gross margin(%) (exc. OOI)	57.5	60.6		58.4			
Employee Expenses	8,589	9,119	(5.8)	8,699	(1.3)	9,776	(12.1)
R&D	3,990	4,075	-2.1	3,580	11.5	3,647	9.4
Other expenses	9,917	12,155	(18.4)	8,984	10.4	9,879	0.4
EBITDA	11,867	14,328	(17.2)	12,094	(1.9)	12,555	(5.5)
EBIDTA margin	20.0	22.1		21.2		20.6	(61.7)
Net finance expense (income)	104	157	14.3	129	5.2	170	(38.7)
Depreciation	2,942	2,573	14.3	2,797	5.2	2,900	1.5
PBT	9,787	12,135	(19.4)	10,267	(4.7)	10,285	(4.8)
Income tax expense	2,709	3,873	(30.1)	2,477	9.4	2,468	9.7
Tax rate (%)	28	32		24		24	
Profit adj for exceptionals and forex	6,956	8,017	(13.2)	7,485	(7.1)	7,814	(11.0)
Reported Profit	6,970	8,063	-13.6	7,700	-9.5	7,814	(10.8)
Adjusted EPS	11.9	13.7	-13.2	12.8	-7.1	13.4	(11.1)

Source: Company, Edelweiss Research

Exhibit 3: Key contributors over medium term

FY22		FY23		FY24	
Product	Peak sales	Product	Peak sales	Product	Peak sales
gVenofer	20	gRevlimid	280	bNeulasta (US)	60
gVelcade	16	bNeulasta (EU)	45	bAvastin (EU)	35
gAccuneb	12	gJanuvia	10	gQvar	35
gAkovaz	10	gCuvposa	9	gXarelto	25
gTruvada	10			gMyrbetriq	25
gCardene	9			gBridion	13
gEmtriva	8				

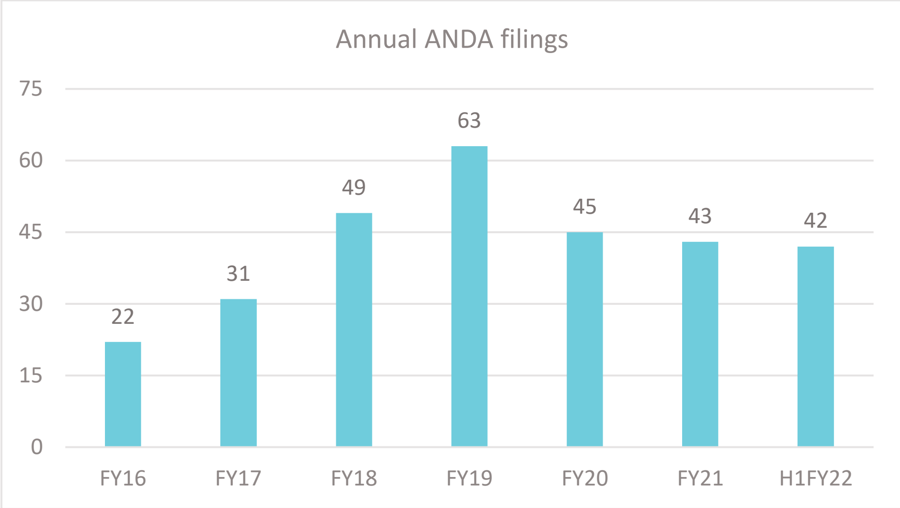
Source: Edelweiss Research

Exhibit 4: Aurobindo pipeline breadth covers USD30bn+ market

	Inhalers	Nasals	Transdermals	Biosimilars	Topicals	Depot inj	Peptides
Pipeline	6 MDIs 2 DPIs	6	8	6	37	3	20
Market size	USD10bn	USD1.3bn	USD3bn	USD15bn+	USD4bn	USD3.3bn	USD2.5bn
Status	1 MDI filed; 2MDI filings expected in FY23	1 (gAstelin) launch. Remaining filing in 18 months	Endpoint study for first product in CY22	EU: 2 filings in Q2/Q3FY22. US: 2 filings before end-FY22. Unit-17 ready	Filed 3 and approval for 1	In clinic	Filed 5 ANDAs using own APIs. Filed 10 DMFs

Source: Company, Edelweiss Research

Exhibit 5: ANDA filing pace remains high



Source: Company

Exhibit 6: Biosimilars could provide potential upside

Molecule	Launch	Probability	Peak sales	NPV/share
bAvastin	FY24 (EU) FY25 (US)	50%	63	7
bNeulasta	FY23 (EU) FY24 (US)	50%	105	30
Others (bLucentis and unnamed ones)	FY25 onwards	20%	125	22

Source: Company, Edelweiss Research

Exhibit 7: Quarterly snapshot (INR mn)

Year to March	Q2FY22	Q2FY21	% change	Q1FY22	% change	YTD FY22	FY22E	FY23E
Net Revenue	59,419	64,834	(8.4)	57,020	4.2	1,16,439	2,40,678	2,59,450
Cost of revenue	25,056	25,157	(0.4)	23,662	5.9	48,718	1,00,122	1,01,964
Gross profit	34,363	39,677	(13.4)	33,358	3.0	67,721	1,40,556	1,57,486
Employee cost	8,589	9,119	(5.8)	8,699	(1.3)	17,288	34,997	38,286
R&D	3,990	4,075	(2.1)	3,580	11.5	7,570	15,403	16,605
Other expenses	9,917	12,155	(18.4)	8,984	10.4	18,902	40,193	43,328
EBITDA	11,867	14,328	(17.2)	12,094	(1.9)	23,961	49,963	59,267
EBITDA margin (%)	20	22		21		21	21	23
Depreciation	2,942	2,573	14.3	2,797	5.2	5,739	11,686	13,256
EBIT	8,925	11,755		9,297		18,222	38,276	46,011
Less: Interest Expense	104	157		129		233	555	490
Add: Other income	966	538	79.7	1,099	(12.1)	2,065	3,268	2,522
Profit before tax	9,787	12,135	(19.4)	10,267	(4.7)	20,054	40,989	48,042
Less: Provision for Tax	2,709	3,873	(30.1)	2,477	9.4	5,187	10,137	11,901
Less: Minority Interest	-3	-6	(51.7)	0		-3	-15	-5
Add: Share of profit from associates	111	205		90		-201	0	0
Reported Profit	6,970	8,063	(13.6)	7,700	(9.5)	15,071	30,867	36,147
Adjusted Profit	6,956	8,017	(13.2)	7,485	(7.1)	14,441	30,427	35,707
No. of Diluted shares outstanding	586	586	0.0	586	0.0	586	586	586
Adjusted Diluted EPS	12	14	(13.2)	13	(7.1)	25	52	61
as % of revenues								
Cost of revenue	42.2	38.8		41.5		41.8	41.6	39.3
Employee cost	14.5	14.1		15.3		14.8	14.5	14.8
R&D	6.7	6.3		6.3		6.5	6.4	6.4
Total operating expenses	80.0	77.9		78.8		79.4	79.2	77.2
Gross profit	57.8	61.2		58.5		58.2	58.4	60.7
Operating profit	15.0	18.1		16.3		15.6	15.9	17.7
Net profit	11.7	12.4		13.5		12.9	12.8	13.9
Tax rate	27.7	31.9		24.1		25.9	24.7	24.8

Source: Company, Edelweiss Research

Company Description

Aurobindo Pharma (ARBP), unlike other major Indian pharma companies, is a pure generic player with export focus that has achieved scale primarily through acquisitions. In its drive to grow via consolidation and gain scale, company has been the most aggressive and also the most successful as company always focused on value. Its aggressive inorganic strategy is much like its global peers, and its strength lies in its execution. Company's future investments are mainly in injectables and now it has started investing meaningfully in biosimilars.

Investment Theme

ARBP has followed a strategy of acquiring portfolios & technologies and bolstering offerings. It is on the cusp of filing transdermals, biosimilars, nasals, inhalers and depot injections. While promising, it also involves high R&D investments that are likely to push R&D to 6% of sales and also increase execution risks vis-a-vis generics. However, gRevlimid settlement offers cushion to the high risk business given that this opportunity will be there for at least 3 years. In the medium term, pipeline of 170 pending ANDAs, its 50 annual launches and injectable capacity expansion should translate to mid-to-high single-digit growth. API expansion, the PLI scheme and contract manufacturing opportunity in vaccines promise long-term growth.

Key Risks

US pricing pressure

Slowdown in ANDA approvals and USFDA related regulatory risks are part of the generics business

Currency fluctuation

Additional Data

Management

Chairman	Mr. K Ragunathan
Vice Chairman	Mr. K Nithyananda Reddy
CFO	S. Subramanian
Managing Director	N. Govindarajan
Auditor	B S R & Associates LLP

Holdings – Top 10*

	% Holding		% Holding
LIC	3.46	BNP	1.22
HDFC AMC	3.37	Dimensional Fun	0.91
vanguard	1.75	SBI Funds	0.84
Blackrock	1.56	ICICI Pru Life	0.63
Nippon AMC	1.26	UTI AMC	0.61

**Latest public data*

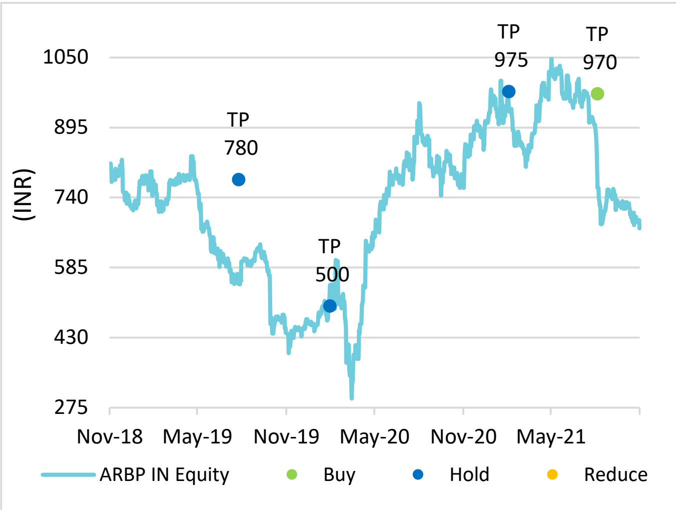
Recent Company Research

Date	Title	Price	Reco
13-Aug-21	Unsurprising miss; *Result Update*	761	Buy
31-May-21	Soft volumes; near-term growth priced in; *Result Update*	998	Hold
11-Feb-21	Steady growth baked in; *Result Update*	935	Hold

Recent Sector Research

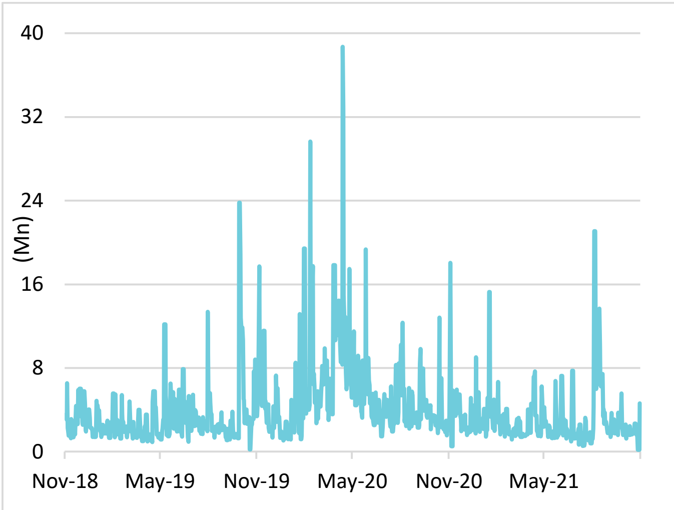
Date	Name of Co./Sector	Title
06-Nov-21	Divi's Lab.	Growth along expected lines; *Result Update*
02-Nov-21	Sun Pharmaceuticals	Progressing along expected lines; *Result Update*
29-Oct-21	Cadila Healthcare	Steady quarter but uncertainties ahead; *Result Update*

Rating Interpretation



Source: Bloomberg, Edelweiss research

Daily Volume



Source: Bloomberg

Rating Distribution: Edelweiss Research Coverage

	Buy	Hold	Reduce	Total
Rating Distribution*	180	57	17	255
	>50bn	>10bn and <50bn	<10bn	Total
Market Cap (INR)	231	39	3	273

**1 stocks under review*

Rating Rationale

Rating	Expected absolute returns over 12 months
Buy:	>15%
Hold:	>15% and <-5%
Reduce:	<-5%

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