



Powered by the Sharekhan 3R Research Philosophy

3R MATRIX

	+	=	-
Right Sector (RS)	✓	■	■
Right Quality (RQ)	✓	■	■
Right Valuation (RV)	✓	■	■
	+ Positive	= Neutral	- Negative

What has changed in 3R MATRIX

	Old		New
RS	■	↔	■
RQ	■	↔	■
RV	■	↔	■

ESG Disclosure Score NEW

ESG RISK RATING
Updated Oct 08, 2021 35.76

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

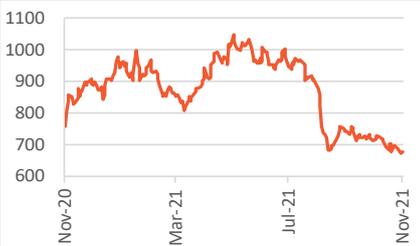
Company details

Market cap:	Rs. 39,665 cr
52-week high/low:	Rs. 1,064 / 660
NSE volume: (No of shares)	31.9 lakh
BSE code:	524804
NSE code:	AUROPHARMA
Free float: (No of shares)	28.2 cr

Shareholding (%)

Promoters	51.8
FII	25.4
DII	12.6
Others	10.19

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.3	-23.7	-33.2	-14.0
Relative to Sensex	-5.9	-34.8	-56.6	-55.9

Sharekhan Research, Bloomberg

Aurobindo Pharma Ltd

Weak quarter; Valuations reasonable

Pharmaceuticals	Sharekhan code: AUROPHARMA		
Reco/View: Buy	↔	CMP: Rs. 677	Price Target: Rs. 875 ↓
↑ Upgrade	↔ Maintain	↓ Downgrade	

Summary

- We retain our Buy recommendation on the stock of Aurobindo Pharma with a revised PT of Rs. 875
- Aurobindo reported a weak performance for Q2FY22 and the results missed estimates due to a lower than expected operating margins. The revenues declined by 8.4% yoy while adjusted PAT declined by 13.7% yoy.
- Headwinds in the form of sustained pricing pressures and higher channel inventories are expected to impact the growth of the US business at-least in the near term. Albeit a strong product pipeline could enable to partly mitigate pricing pressures.
- Over the long term, a sturdy product pipeline in the US, focus on growing the injectables business and building a strong portfolio of specialty products including biosimilars would be the key growth drivers.

Aurobindo Pharma (Aurobindo) reported a weak performance for the quarter and the results missed estimates due to a lower than expected operating margins. The numbers are not comparable due to divesture of Natrol business. Consolidated revenues at Rs 5942 cr declined by 8.4% y-o-y, while adjusted PAT at Rs 696.7 cr declined by 13.7% y-o-y. Higher raw material costs and logistics costs led to a sharp contraction in gross margins which resulted in a 210-bps y-o-y OPM contraction to 20%. Aurobindo's US business continues to witness near term uncertainties in the form of higher pricing pressures, but going ahead the same could be partly offset by a sturdy new product pipeline. Other growth levers such as efforts to enhance presence in the complex generics and focus on building a strong portfolio of specialty products would be key long-term growth drivers

Key positives

- US sales at Rs 2967.6 crores grew by 6.9% y-o-y despite higher pricing pressures and driven by higher volumes growth in the Oral Solids.
- Europe business grew sturdily by 9.7% y-o-y with the revenue share increasing by 3% y-o-y to 28%

Key negatives

- ARV sales declined 71% y-o-y due to higher stocking on advanced procurement in Q2FY21
- Delays for regulatory inspections / clearance

Management Commentary

- The US sales constitutes around half of the overall sales and Aurobindo sees headwinds in the form of higher price erosion due to elevated channel stocks across industry. Pricing pressures are likely to sustain until inventories normalize, thus pointing at uncertainties at-least in the near term.
- Aurobindo has a strong product filing pipeline for the US and plans to file around 40-50 products in FY2022 including injectables.
- The management has retained its guidance of achieving \$650-700 mn of sales from the injectables over the next 3 years backed by a strong product pipeline

Revision in estimates – Q2FY22 was a weak quarter and the results missed estimates. Further, basis the uncertainties persisting for its US business as well as weak performance of ARV segment, we have revised our earnings estimates downwards by around 5% each for FY22E and FY23E.

Our Call

Valuation - Maintain Buy with a revised PT of Rs. 875: Near term uncertainties exists for Aurobindo's US business in the form of high pricing pressures and delay in regulatory clearances for its plants. Over the long term, a sturdy product pipeline in the US, focus on growing the injectables business and building a strong portfolio of specialty products including biosimilars would be the key growth drivers. At CMP, the stock is trading at a valuation of 11.8x and 10.2x its FY22E and FY23E EPS, which is attractive and provides comfort. A possible de-merger of the injectables business could provide value unlocking opportunities. Hence we retain our Buy recommendation on the stock with a revised PT of Rs. 875

Key Risks

Delay in resolution of USFDA issues and product approvals; change in regulatory landscape; and negative outcome of key facility inspection by USFDA can affect earnings prospects.

Valuation (Consolidated)

Particulars	Rs cr				
	FY2020	FY2021	FY2022E	FY2023E	FY2024E
Total Income	23098.5	24774.6	25293.0	28000.6	30664.7
Operating profits	4864.3	5333.4	5438.0	6160.1	6991.6
OPM (%)	21.1	21.5	21.5	22.0	22.8
Adj. PAT	2914	2474	3365	3889	4485
EPS (Rs)	49.7	42.2	57.4	66.4	76.6
PER (x)	13.6	16.0	11.8	10.2	8.8
EV/Ebitda (x)	8.7	7.2	6.4	5.0	3.8
P/BV (x)	2.4	1.8	1.6	1.4	1.2
ROCE (%)	17.7	18.6	16.8	18.1	18.7
RONW (%)	19.0	12.8	14.3	14.4	14.5

Source: Company; Sharekhan estimates

Weak Quarter; results miss estimates: Aurobindo reported a weak performance for the quarter and the results missed the estimates due to a lower than estimated operating margins. The numbers are not comparable due to divestiture of Natrol business. Consolidated revenues at Rs 5942 cr declined by 8.4% y-o-y and were marginally below the estimates. While the US and Europe sales were up 7% and 10% y-o-y respectively, the growth markets and ARV sales declined by 14% and 71% y-o-y respectively. The operating profits at Rs 1186.7 cr declined by 17.2% y-o-y and were below estimates. The operating margins at 20% contracted by 210 BPS yoy. The contraction in the gross margins to the tune of 340 BPS y-o-y led to OPM contraction. Higher prices for some of the key raw materials and higher logistics costs impacted the gross margins. The operating margins missed estimates. Tracking the operating performance, the PAT for the quarter at Rs 696.7cr declined by 13.7% y-o-y and missed estimates

Q2FY2022 Conference call highlights

- ◆ **US sales though improve sequentially, but uncertainty persists:** The US markets accounts for around half of the company's overall revenues of the Aurobindo. The US sales for Q2FY2022 are up 6.9% y-o-y and 11% sequentially, adjusting for Natrol divestment. The growth on a y-o-y basis is driven by a strong volume growth in the oral solid dosages (OSD) despite the high single digit price erosion. The volume growth could be attributable to the demand postponement in the past and going ahead the management sees the volumes growth to largely sustain. However, the price erosion in the US markets continues to be on the higher side (in high single digits). Excess of channel inventory across the industry is leading to higher price erosion and could normalize once the inventories normalize. However, uncertainty around the time frame for liquidation of the inventories exists and hence could exert margins pressures until fully normalized.
- ◆ **Strong product Pipeline for the US markets:** Aurobindo has a strong product pipeline planned for the US markets including the Injectables. As on September 2021, the company has a total of 681 ANDAs filed with the USFDA which includes 456 approved ones while 29 are with tentative approvals and 196 ANDA's under review, which is a substantially strong product pipeline. Further in Q2FY2022 Aurobindo received a total of 7 ANDA approvals including 2 injectables and one products approved under the 505(b)(2) pathway and the company has filled for a strong 27 ANDAs in Q2FY22 with 5 injectables. Aurobindo has launched 6 new products in the US during the quarter and the same included 3 injectables products. Further the company has also guided for a string 40-50 product filling pipeline in the US in FY2022. Collectively, a strong overall new product pipeline, focus on injectables business and a gradual improvement in the complex generics would be the key growth drivers for the US business over the longer term, but near-term headwinds in the form of higher than expected price erosion and channel inventory buildup would slow down the growth in the US topline.
- ◆ **Specialty basket – Injectables & biosimilar to gain traction gradually:** Aurobindo has set its eyes on the high-margins injectables business and sees it as one of the key growth levers. For Q2FY22 the injectables revenues were up 5% y-o-y to \$68 mn. The company has built a strong presence in injectables across delivery systems such as liquid & lyophilized vials, bag, ampoules and pre filled syringes and has a strong manufacturing and execution capabilities as well. Also the company has a sturdy pipeline in the injectables with around 28 product approvals in the US only and the same is increasing as new injectables are approved. The global injectables sales for the quarter stand at ~ \$ 105 mn and Aurobindo has retained its guidance and expects the annual run rate for the injectable products to touch ~\$650-700 million over the next three years by FY2024. In addition to the injectables, Aurobindo is planning to file 2 Biosimilars products in the oncology space in FY22 and looks to add 1-2 products every year. The fillings would be done across the European as well as the US markets.

- ♦ **Europe:** The EU formulations revenues grew strong by 9.7% y-o-y to 1662.3 crore and constituted around 28% of the quarterly sales as compared to 25% in the corresponding quarter of the previous year. Sequentially the revenues were up 5%
- ♦ **Anti-retroviral (ARV):** The revenues from the segment declined sharply by 71.2% y-o-y to Rs 145 crore attributable to the higher stocking on advanced procurement in previous year due to possibilities of covid led uncertainties.
- ♦ **Growth Market formulations:** The revenues from the segment at RS 386.3 crore declined by 13.7% y-o-y but grew by 17% on a sequential basis. The growth sequentially was driven by a strong growth in Canada, Brazil and Other markets.
- ♦ **Regulatory updates:** Aurobindo's unit 1 which was under the USFDA scrutiny was inspected in the recent past and the inspection ended with a form 483. The company has submitted its responses to the agency and is awaiting a response. Also currently the Aurolife (US plant) is being inspected by the USFDA and the outcome of the same is awaited. The balance plants – 7,9 and 11 still continue to be under the USFDA scrutiny with an OAI/WL status.

Results (Consolidated)

Particulars	Q2FY2022	Q2FY2021	YoY %	Q1FY2022	QoQ%
Total Income	5941.9	6483.4	-8.4	5702.0	4.2%
Operating expenditure	4755.2	5050.6	-5.8	4492.6	5.8%
Operating profit	1186.7	1432.8	-17.2	1209.4	-1.9%
Other income	94.7	47.2	100.7	81.3	16.5%
EBIDTA	1281.4	1480.0	-13.4	1290.7	-0.7%
Interest	10.4	15.7	-33.7	12.9	-19.1%
Depreciation	294.2	257.3	14.3	279.7	5.2%
PBT	976.8	1206.9	-19.1	998.1	-2.1%
Tax	270.9	385.7	-29.8	247.7	9.4%
PAT	696.7	807.3	-13.7	770.0	-9.5%
EPS (Rs)	11.9	13.8	-13.7	13.2	-9.5%
Margins			BPS		BPS
OPM (%)	20.0	22.1	-213	21.2	-124
Adj PAT margin (%)	11.7	12.5	-73	13.5	-178
Tax rate (%)	27.7	32.0	-422	24.8	291

Source: Company; Sharekhan Research

Revenue mix

Particulars	Q2FY2022	Q2FY2021	YoY %	Q1FY2022	QoQ%
USA	2967.6	2775.3	6.9	2681.0	10.7
Europe	1662.3	1514.8	9.7	1582.9	5.0
Growth Markets	386.3	446.5	(13.5)	329.3	17.3
ARV	145.0	502.7	(71.2)	296.4	(51.1)
Formulations	5161.2	5239.3	(1.5)	4889.6	5.6
Betalactams	420.8	434.4	(3.1)	383.6	9.7
Non Betalactams	359.8	394.6	(8.8)	428.3	(16.0)
API	780.6	829.0	(5.8)	811.9	(3.9)
Gross Sales	5941.8	6068.3	(2.1)	5701.5	4.2
Dossier Income	0.0	0.6	-	0.2	-
Net Sales	5941.8	6068.9	(2.1)	5701.7	4.2

Source: Company; Sharekhan Research; Numbers adjusted for Natrol divestment

Outlook and Valuation

■ Sector view – Improved growth prospects

Indian pharmaceutical companies are better-placed to harness opportunities and clock a healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in the US generics market), rise in product approvals and plant resolutions by the USFDA coupled with strong growth prospects in domestic markets and emerging opportunities in the API space would be the key growth drivers. This would be complemented by the strong capabilities developed by Indian companies (leading to a shift towards complex molecules, biosimilars) and the commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharma companies

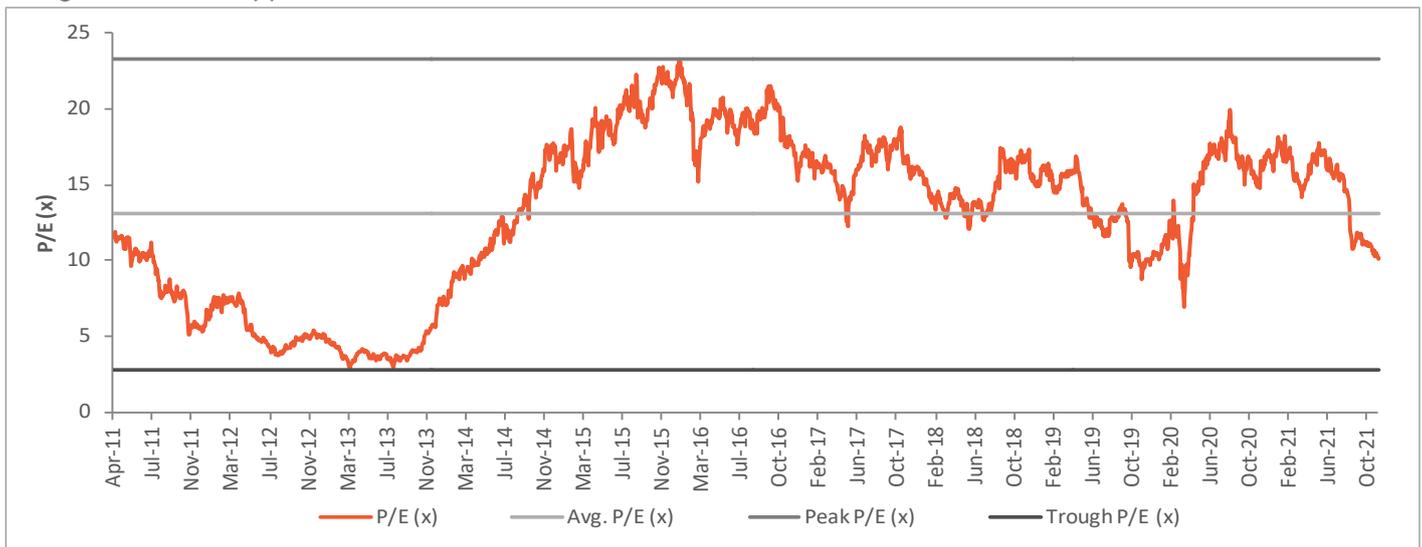
■ Company outlook – Near term uncertainties to stay

Over the long term a healthy growth outlook exists for the US business driven by an improving traction from the generic Injectables space (with comparatively low competition), a sturdy product pipeline and expected traction the recently launched products. However, in the near term there are headwinds emerging for the US business in the form of price erosion and inventory buildup across channels in the industry. While the strong product pipeline planned for the US could enable partly mitigation of price erosion, the higher channel stocks are likely to pressurize the topline growth until the stocks normalize, thus pointing at near term uncertainties. The European business has a robust growth outlook backed by product portfolio expansion and expanding geographic reach. However, Aurobindo is awaiting USFDA clearance for five of its plants. A successful resolution of USFDA observations would be a key monitor able and a trigger for earnings upgrade. Over the long term, Aurobindo is looking to build a presence in the specialty segment which includes areas of biosimilars, oncology inhalers, transdermal patches amongst others which is likely to support growth.

■ Valuation - Maintain Buy with a revised PT of Rs. 875

Aurobindo is witnessing headwinds for its US business in the form of sustained higher price erosion and built of inventories across channels. These headwinds are expected to exert pressures on US revenues at least in the near term, pointing at uncertainties. While the company has a strong product launch pipeline in US in FY2022, which could enable mitigate the impact of the price erosion, but lack of clarity exists around liquidation of higher channel stocks. The other geographies such as Europe have a strong growth outlook. Further Aurobindo is on track to file for its biosimilar products in FY2022. Also the injectables business is growing at a healthy pace and the company has retained its guidance of achieving a \$650-700 mn turnover over the next 3 years. Given the weak performance in Q2FY2022 and headwinds for its US business we have revised our estimates downwards for FY22E/FY23E by ~5% each. At CMP, the stock is trading at a valuation of 11.8x and 10.2x its FY22E and FY23E EPS, which is attractive and provides comfort. A possible de-merger of the injectables business could provide value unlocking opportunities. Hence we retain our Buy recommendation on the stock with a revised PT of Rs. 875.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBITDA (x)			RoE (%)		
				FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
AurobindoPharma	677.0	58.6	39,665.0	16.0	11.8	10.2	7.2	6.4	5.0	12.8	14.3	14.4
Lupin	937.0	45.2	42,535.0	34.9	28.5	20.9	18.2	12.9	9.7	8.8	10.0	12.2
Dr Reddy's	4,791.0	16.6	79,720.0	40.8	28.9	22.8	16.2	14.8	12.1	11.1	14.4	16.4

Source: Company, Sharekhan estimates

About company

Hyderabad-based Aurobindo was incorporated in 1986 and manufactures generic formulations and active pharmaceutical ingredients (APIs). Aurobindo generates 90% of its sales from international markets. The company currently holds a strong position in the US, where it is the fifth largest generic pharmaceutical company as per the IMS National Prescription Audit, measured by total prescriptions dispensed for the 12 months ending June 2018. The company also holds a strong position in many European countries, including France and Italy, where it ranks among the largest generic companies. Aurobindo is a vertically integrated company, meeting around 70% of its API requirements in-house. Aurobindo has 26 manufacturing facilities for its API and formulations businesses, which have requisite approvals from various regulatory authorities, including the USFDA, U.K. MHRA, Japan PMDA, WHO, Health Canada, MCC South Africa and ANVISA Brazil. Recently, Aurobindo entered Poland and the Czech Republic with the acquisition of Apotex's commercial operations. The company also strengthened its US presence with the acquisition of dermatology and oral solid businesses from Sandoz.

Investment theme

Aurobindo has one of the best product approval rates and launch pipelines in the US. Despite pricing pressures, the company is one of the few companies able to mitigate this risk due to continuous product launches and approvals. The company is currently grappling through a USFDA scorecarding at its various plants. Continued regulatory concerns are likely to impact performance adversely going ahead, as more than 50% of the company's fillings are from plants that are under USFDA scorecarding.

Key Risks

Delay in product approvals; change in regulatory landscape; and negative outcome of key facility inspections by the USFDA can affect earnings prospects.

Additional Data

Key management personnel

K Nithyananda Reddy	Vice - Chairman, Whole-time Director, promoter.
N Govindarajan	Managing Director
P.V. Ramaprasad Reddy	Non-executive Director, Promoter
Santhanam Subramanian	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co Ltd	5.67
2	Axis Clinicals Ltd	3.0
3	Vanguard Group Inc/The	1.59
4	BlackRock Inc	1.34
5	Dimensional Fund Advisors LP	1.13
6	SBI Funds Management Pvt Ltd	0.94
7	ICICI Prudential Life Insurance Co	0.69
8	Norges Bank	0.49
9	IDFC Mutual Fund/India	0.44
10	Invesco Ltd	0.4

Source: Bloomberg

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