

## AUROBINDO PHARMA

PHARMACEUTICALS

16 NOV 2016

Quarterly Update

**BUY**

Target Price: Rs 940

### In-line EBITDA; US growth visibility remains

Aurobindo's (ARBP) Q2FY17EBITDA at Rs 9.3 bn (up 20% YoY) was inline with our estimate. While the growth (14% YoY, 2% QoQ) in US sales (USD 259mn) was marginally below our expectation, increase in gross margin by 150bps YoY to 56.8%, EBITDA margin by 135bps YoY to 24.6%, and reduction in net debt (USD 484 mnvs USD 525 mn in June'16) were key positives. It expects US growth to improve given visibility of launches in H2'17and EBITDA margin of over 24%.

We cut FY17/18E EPS by 5%/9% to factor in the increasing pricing pressure in US and delay in launches. We revise TP to Rs 940 (18x Sept 18) vs. Rs 970 (18x FY18E EPS) earlier. Maintain **BUY** given strong US pipeline and gradual turnaround in EU place ARBP in a sweet spot.

CMP : Rs 772  
Potential Upside : 22%

#### MARKET DATA

No. of Shares : 585mn  
Free Float : 46%  
Market Cap : Rs 452 bn  
52-week High / Low : Rs 895 / Rs 582  
Avg. Daily vol. (6mth) : 2.1 mn shares  
Bloomberg Code : ARBP IB Equity  
Promoters Holding : 54%  
FII / DII : 27% / 8%

- ◆ **US (46% of sales)** grew 14% YoY (in USD terms) despite increase in price erosion (6-8% vs. 4-6% in past) in base business, as led by volume gains in oral solids and strong growth in injectables (>100% YoY). EU business (22% of sales) grew 6% YoY (-2% QoQ), driven by 4% YoY increase in Euro/INR in Q2. EU profitability has improved to mid-single digit; on track to achieve 7-8% margin by FY18. ARV growth was muted (-1% YoY), RoW markets growth was 13% YoY and API grew 11% YoY
- ◆ **US sales growth and margins to remain steady:** US growth to remain steady given ongoing volume gains in oral products, scale up in niche injectables (glucosulfan blue, glinteriglin) coupled with pick-up in new launches (as has only launched 11 of the 30-35 planned in FY17) and new approvals in orals (Nexium, etc) and injectables (gVancomycin, Meropenem, etc) in H2FY17. ARBP has increased the level of Inventory in the US market as it prepares for new launches and also higher safety stock for customers (in order to improve the service levels). With 128 ANDAs pending (33 injectables), we expect 15% CAGR over FY17-19 in US. This coupled with turnaround in EU would improve EBITDA margin from 23.1% in FY16 to 24.4/24.7% in FY17/18 *(Continued on page 2...)*

#### Financial summary (Consolidated)

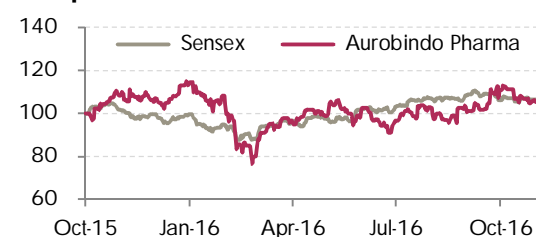
Y/E March	FY16	FY17E	FY18E	FY19E
Sales (Rs mn)	138,887	155,986	175,931	197,678
Adj PAT (Rs mn)	20,300	24,669	28,639	32,492
Con. EPS* (Rs)	-	42.2	50.4	56.1
EPS (Rs)	34.7	42.2	48.9	55.5
Change YOY (%)	25.1	21.5	16.1	13.5
P/E (x)	22.3	18.3	15.8	13.9
RoE (%)	33.2	30.6	27.4	24.3
RoCE (%)	27.6	27.7	27.8	27.6
EV/E (x)	15.1	12.8	10.8	9.3
DPS (Rs)	2.5	2.5	2.5	2.5

Source: \*Consensus broker estimates, Company, Axis Capital

#### Key drivers

Growth (%)	FY16	FY17E	FY18E
US (USD)	20	12	16
Europe	(2)	7	8
EBITDA margin	23.1	24.4	24.7
core-EPS	25	22	16

#### Price performance



(...continued from page 1)

- ◆ **Key concall highlights:** (1) **Net debt** as on H1'17 stood at USD 484 mn (vs. USD 525 mn in Jun'16 post USD 150 mn of debt factoring in Q1'17); (2) **R&D expense to increase** to ~5% of sales in the near term given the complex initiatives (oncology, hormones, complex injectables like microsphere, liposomals, etc) enter clinics, expect Depo Inj. to enter clinics in end CY18; (3) **Scaling up EU:** Moved production of 37 products; aiming to move 42 in the near term), with the EU GMP certification received for Unit XV, expect sales to commence from Q4'17, incremental 72 products (total 114 products, representing 40% of unit sales) would be moved to India; (4) **Acquisition strategy** mainly revolves in getting market expansion or adding new platforms specifically in the European market

### Exhibit 1: ARBP's growth continues to be led by US business

(Rs mn)	Q2'16	Q1'17	Q2'17	YoY (%)	QoQ (%)
US (USD mn)	227	255	259	14	2
US	14,727	17,039	17,351	18	2
Europe	7,643	8,312	8,134	6	(2)
ARV	2,802	3,030	2,785	(1)	(8)
RoW	1,560	1,940	1,768	13	(9)
<b>Formulations</b>	<b>26,732</b>	<b>30,321</b>	<b>30,038</b>	<b>12</b>	<b>(1)</b>
<b>API</b>	<b>6,911</b>	<b>7,346</b>	<b>7,688</b>	<b>11</b>	<b>5</b>
<b>Gross revenue</b>	<b>33,652</b>	<b>37,667</b>	<b>37,754</b>	<b>12</b>	<b>0</b>

Source: Company

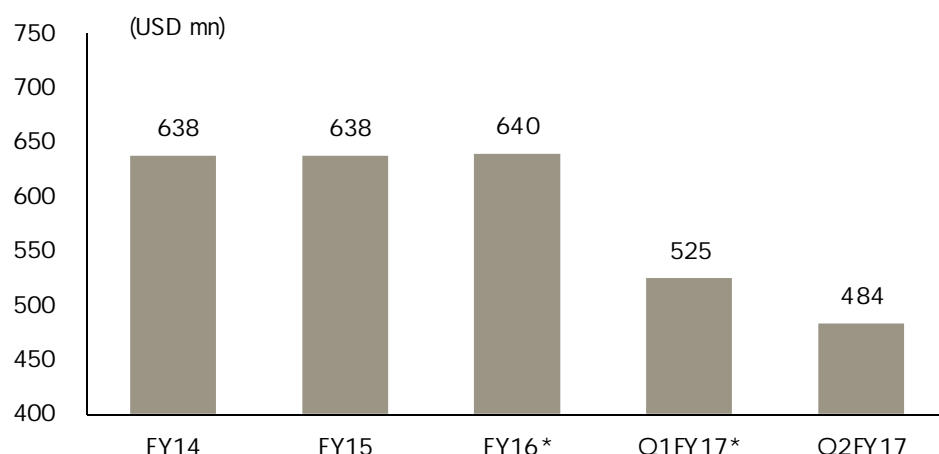
### Exhibit 2: Margin improvement led by higher operating leverage from better product mix

(Rs mn)	Q2'16	Q1'17	Q2'17	YoY (%)	QoQ (%)
Net revenue	33,652	37,259	37,755	12	1
Gross Profit	18,530	20,889	21,456	19	8
Gross margin (%)	55.1	56.5	56.8	176 bps	29 bps
Employee Expenses	3,730	4,321	4,266	14	(1)
% of revenue	11	11	11	22 bps	-16 bps
Other Expenses	7,009	7,679	7,898	13	3
% of revenue	21	20	21	10 bps	55 bps
<b>EBITDA</b>	<b>7,790</b>	<b>8,890</b>	<b>9,292</b>	<b>19</b>	<b>5</b>
<b>EBITDA margin (%)</b>	<b>23.1</b>	<b>23.9</b>	<b>24.6</b>	<b>146 bps</b>	<b>75 bps</b>
Other income	122	159	83	(32)	(48)
Forex (gain)/ loss	439	(70)	(202)	N.A	N.A
Depreciation	926	1,062	1,102	19	4
Interest	241	206	175	(27)	(15)
PBT	6,306	7,850	8,299	32	6
Minorities	25	(7)	5	(80.4)	(173.1)
Tax	1,767	2,008	2,240	26.8	11.5
<b>Reported PAT</b>	<b>4,536</b>	<b>5,850</b>	<b>6,056</b>	<b>34</b>	<b>4</b>
<b>Adj. PAT*</b>	<b>4,878</b>	<b>5,800</b>	<b>5,913</b>	<b>21</b>	<b>2</b>

Source: Company As per Ind-AS

\*PAT adjusted for forex

### Exhibit 3: ARBP expects net debt to continue to decline by Mar'17



Source: Company, Axis Capital \*Note FY16 debt adjusted for bill-discounting (as per Ind-As); Q1FY17 adjusted for debt factoring of USD 150 mn

### Conference call highlights

**US business (46% of sales; USD 259 mn +14% YoY in USD terms):** Growth was led by new launches in orals and injectables. Three products launched towards the end of the quarter. Launched 11 products in generic OSDs during H1; expect a total of 30 to 35 launches in FY17

- ◆ **Injectables:** Sales were at USD 38 mn in Q2, on target for USD 150 mn in FY17. Eptifibatide sales have been lower than previous quarter as Merck has been able to re-launch product. Isosulfan blue sales are picking up. Expect to see improvement in sales in the segment in H2. 4 products launched in Q2 and 6 to 7 launches planned for H2, which would be significant products (incl. Vancomycin)
- ◆ **gNexium:** Opportunity has not significantly diminished despite later launch of the product
- ◆ **Aurolife:** Has added 20 new customers. Expect to see meaningful growth only once critical mass is reached
- ◆ **Natrol:** Performance is as expected and growth momentum is maintained
- ◆ **Nuvigil:** Launched AG version; would expect to launch its own generic in multiple dosage levels
- ◆ **Price erosion:** Expect price erosion in the base business to be at 6 to 8% for the full years (vs. earlier expectation of 4 to 6%), given increasing competitive pricing as well as McKesson-Walmart deal. Price competition has been heightened across segments with pressure on both wholesale and retail sides of the business. Was able to offset base business price erosion on improved volumes, which should continue in Q3 (aided also by 15 launches in H2'17)

**EU business (22% of sales):** Transferred manufacturing of one more product to India (with a total of 37 products now transferred). EU GMP certification has been received for Unit XV and expect formal sales to commence during Q4'17. EBITDA margin is in mid-single digit range, and on course for high single digit margin for FY17. 72 products (excl. 42 products which would be transferred in Phase I) have been identified for EU which would be made from the new unit (40% of the units total sales).

**R&D:** R&D expenses were at 3.9% of sales in Q2 (vs 3.8% of sales (Rs 4.7 bn) in FY16). ARBP filed 9 ANDAs (6 in orals and 3 in injectables) in Q2 (14 in H1; 22 in FY16) and received 17 approvals (15 FA and 2 TA). R&D would increase as complex product filings (depo-injectables, biosimilars, vaccines) increase with clinical trials (expect to reach ~5% of sales in the medium term). Plan to file for depo-injectable products from CY18, which could see R&D expense increase to ~7%

- ◆ **Peptides:** 3 DMFs have already been filed with one more expected to be filed. Focus is to improve filing rate as 2 more products have been commissioned, with the aim to enhance product offerings
- ◆ **Depolnj:** Expect clinical trials to start from end of CY18

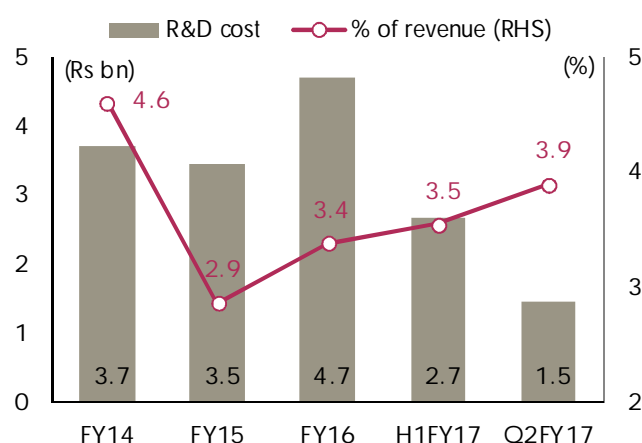
**P&L:** Aim is to maintain EBITDA margin of 24% to 25% for FY17. Raw material cost have been lower which aided gross margin expansion by 70 bps

**Balance sheet:** Net debt currently stands at USD 484 mn (vs USD 525 mn in Jun'16 post USD 150 mn of debt factoring in Q1'17). In the previous quarter, net debt of USD 584 mn in Mar'16 was reclassified as USD 640 mn given inclusion of bill-discounting (as per IND-AS adjustments). Cash and cash equivalents stands at USD 107 mn. Increase in inventory on account of higher safety stock in preparation for customers (currently has 2 months' worth) as well as planning for new launches

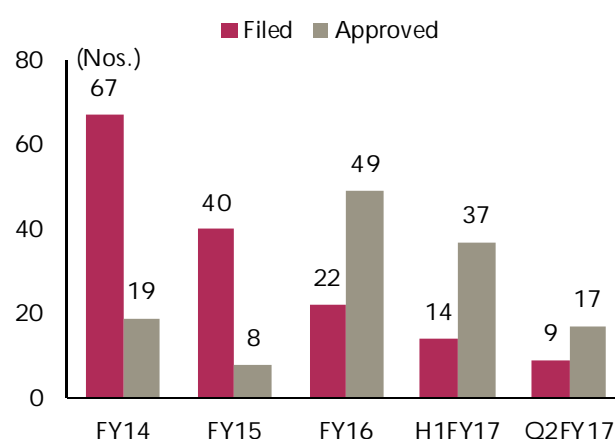
**Tax rate:** Effective tax rate of 27% during the quarter

**Capex:** USD 40 mn of capex during the quarter

**Acquisitions:** Strategy is to expand market presence and enhance assets in Europe to help improve EBITDA of that geography

**Exhibit 4: R&D expense expected to increase to ~5%...**


Source: Company

**Exhibit 5: ...to support continued filing momentum**


Source: Company

**Exhibit 6: Facility-wise ANDA filings**

	Filed				Approved				Pending			
	Mar-15	Mar-16	Jun-16	Sep-16	Mar-15	Mar-16	Jun-16	Sep-16	Mar-15	Mar-16	Jun-16	Sep-16
Total Orals	289	309	312	317	166	202	217	227	123	107	95	90
Unit VII (SEZ)	138	148	151	155	37	69	81	89	101	79	70	66
Total Injectables	79	81	83	86	18	41	44	49	61	40	39	37
Unit IV	66	67	68	71	8	30	33	38	58	37	35	33
<b>Total</b>	<b>368</b>	<b>390</b>	<b>403</b>	<b>412</b>	<b>184</b>	<b>243</b>	<b>269</b>	<b>284</b>	<b>184</b>	<b>147</b>	<b>134</b>	<b>128</b>

Source: Company

Note: 284 FAs includes 41 TAs

**Exhibit 7: Market share trends in key products**

Generic name	Brand name	Brand sales / mkt size(USD mn)	#No. of players	Market share					
				Jun'15	Sep'15	Dec'15	Mar'16	Jun'16	Sep'16
Rosuvastatin Calcium*	Crestor	6,780	9	-	-	-	-	-	9%
Pantoprazole Sodium. Inj.	Protonix	94	3	-	-	-	10%	13%	7%
Valganciclovir	Valcyte	440	4	-	-	-	-	5%	10%
Isosulfan Blue	Lymphazurin	57	2	-	-	-	15%	46%	53%
Aripiprazole	Abilify	4,764	7	-	-	3%	6%	7%	7%
Entecavir	Baraclude	294	4	-	5%	6%	18%	41%	43%
Eptifibatide Inj.	Interiglin	137	2	-	-	1%	68%	59%	55%
Cefixime OS	Suprax	80	2	12%	18%	21%	24%	26%	23%
Tazo-pip	Zosyn	635	7	22%	35%	20%	14%	10%	7%
Duloxetine*	Cymbalta	5,100	16	22%	20%	24%	24%	24%	24%
Valsartan+HCTZ	Diovan HCT	1,700	8	25%	28%	29%	30%	29%	31%
Lamivudine+ Zidovudine	Combivir	275	7	20%	21%	23%	16%	8%	9%
Metformin	Glucophage	-	>10	16%	17%	25%	25%	17%	15%

Source: Bloomberg, Company, Axis Capital\* sold through partner Citron Pharma

**Exhibit 8: R&D investments for the future**

Key areas of Investments	Key initiatives	No of Products	Filings
OTC (Over the counter) & softgel products	Acquired production facility in Lawrenceville, NJ US	35	Yes (ANDA filings)
Peptides	<ul style="list-style-type: none"> <li>◆ Filed 3 DMF's and work ongoing on more</li> <li>◆ Forward integrating by developing microspheres (Mkt. size USD 3 bn)</li> </ul>	More than 10	2015 (DMF filings)
Oncology & Hormonal products	Dedicated R&D centre to develop solid and parenteral dosages- Exhibit batches for 5 hormones and 15 oncology products are scheduled in FY16-17	63	2015-16 (DMF filings)
Penems (injectables)	◆ Filings of all products (four) complete	4	ANDA filings
Synthetic nutraceuticals	Process development work completed	-	-
Dry Powder Inhalers (DPI), Patches, Films and Depot injections	Under development	-	-

Source: Company

## Financial summary (Consolidated)

### Profit & loss (Rs mn)

Y/E March	FY16	FY17E	FY18E	FY19E
Net sales	138,887	155,986	175,931	197,678
Other operating income	74	100	100	100
<b>Total operating income</b>	<b>138,961</b>	<b>156,086</b>	<b>176,031</b>	<b>197,778</b>
Cost of goods sold	(61,575)	(68,170)	(75,398)	(82,483)
Gross profit	77,386	87,917	100,633	115,295
<i>Gross margin (%)</i>	<i>55.7</i>	<i>56.4</i>	<i>57.2</i>	<i>58.3</i>
Total operating expenses	(45,330)	(49,839)	(57,085)	(66,824)
<b>EBITDA</b>	<b>32,056</b>	<b>38,078</b>	<b>43,548</b>	<b>48,471</b>
<i>EBITDA margin (%)</i>	<i>23.1</i>	<i>24.4</i>	<i>24.8</i>	<i>24.5</i>
Depreciation	(3,926)	(4,432)	(4,815)	(5,199)
<b>EBIT</b>	<b>28,130</b>	<b>33,646</b>	<b>38,733</b>	<b>43,272</b>
Net interest	(927)	(774)	(615)	(415)
Other income	682	853	1,134	1,509
<b>Profit before tax</b>	<b>27,704</b>	<b>33,725</b>	<b>39,252</b>	<b>44,366</b>
Total taxation	(7,444)	(9,106)	(10,559)	(11,934)
<i>Tax rate (%)</i>	<i>26.9</i>	<i>27.0</i>	<i>26.9</i>	<i>26.9</i>
Profit after tax	20,261	24,619	28,694	32,431
Minorities	39	50	(55)	61
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	20,300	24,669	28,639	32,492
<i>Adj. PAT margin (%)</i>	<i>14.6</i>	<i>15.8</i>	<i>16.3</i>	<i>16.4</i>
Net non-recurring items	(480)	-	-	-
Reported net profit	19,820	24,669	28,639	32,492

### Balance sheet (Rs mn)

Y/E March	FY16	FY17E	FY18E	FY19E
Paid-up capital	585	585	585	585
Reserves & surplus	69,982	90,292	117,570	148,701
Net worth	70,567	90,877	118,155	149,287
Borrowing	40,762	40,762	30,762	20,762
Other non-current liabilities	2,364	2,364	2,364	2,364
<b>Total liabilities</b>	<b>156,993</b>	<b>168,617</b>	<b>190,244</b>	<b>216,118</b>
Gross fixed assets	62,110	75,110	81,610	88,110
Less: Depreciation	(19,713)	(24,144)	(28,959)	(34,158)
Net fixed assets	42,398	50,966	52,651	53,953
Add: Capital WIP	10,238	10,238	10,238	10,238
Total fixed assets	52,635	61,204	62,889	64,190
Total Investment	2	2	2	2
Inventory	40,881	44,873	50,610	56,866
Debtors	41,719	43,591	49,164	55,241
Cash & bank	8,344	3,852	10,888	21,387
Loans & advances	10,795	12,479	14,074	15,814
Current liabilities	42,704	34,018	38,367	43,110
Net current assets	61,652	73,393	88,986	108,816
Other non-current assets	-	-	-	-
<b>Total assets</b>	<b>156,993</b>	<b>168,617</b>	<b>190,244</b>	<b>216,118</b>

Source: Company, Axis Capital

### Cash flow (Rs mn)

Y/E March	FY16	FY17E	FY18E	FY19E
Profit before tax	27,704	33,725	39,252	44,366
Depreciation & Amortisation	(3,926)	(4,432)	(4,815)	(5,199)
<i>Chg in working capital</i>	<i>(5,558)</i>	<i>(14,297)</i>	<i>(6,709)</i>	<i>(7,339)</i>
<b>Cash flow from operations</b>	<b>19,223</b>	<b>18,108</b>	<b>30,343</b>	<b>33,988</b>
<i>Capital expenditure</i>	<i>(15,682)</i>	<i>(13,000)</i>	<i>(6,500)</i>	<i>(6,500)</i>
<b>Cash flow from investing</b>	<b>(15,682)</b>	<b>(13,000)</b>	<b>(6,500)</b>	<b>(6,500)</b>
<i>Equity raised/ (repaid)</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>(5,173)</i>	<i>-</i>	<i>(10,000)</i>	<i>(10,000)</i>
<i>Dividend paid</i>	<i>(1,342)</i>	<i>(1,584)</i>	<i>(1,584)</i>	<i>(1,584)</i>
<b>Cash flow from financing</b>	<b>(14,874)</b>	<b>(2,358)</b>	<b>(12,199)</b>	<b>(11,999)</b>
Net chg in cash	(11,332)	2,750	11,644	15,489

### Key ratios

Y/E March	FY16	FY17E	FY18E	FY19E
<b>OPERATIONAL</b>				
FDEPS (Rs)	34.7	42.2	48.9	55.5
CEPS (Rs)	40.6	49.7	57.2	64.4
DPS (Rs)	2.5	2.5	2.5	2.5
Dividend payout ratio (%)	7.4	5.9	5.1	4.5
<b>GROWTH</b>				
Net sales (%)	14.7	12.3	12.8	12.4
EBITDA (%)	25.0	18.8	14.4	11.3
Adj net profit (%)	25.4	21.5	16.1	13.5
FDEPS (%)	25.1	21.5	16.1	13.5
<b>PERFORMANCE</b>				
RoE (%)	33.2	30.6	27.4	24.3
RoCE (%)	27.6	27.7	27.8	27.6
<b>EFFICIENCY</b>				
Asset turnover (x)	1.5	1.3	1.3	1.4
Sales/ total assets (x)	1.0	1.0	1.0	1.0
Working capital/ sales (x)	0.4	0.4	0.4	0.4
Receivable days	109.6	102.0	102.0	102.0
Inventory days	139.6	138.8	139.4	139.0
Payable days	86.3	85.9	86.3	86.1
<b>FINANCIAL STABILITY</b>				
Total debt/ equity (x)	0.7	0.5	0.3	0.2
Net debt/ equity (x)	0.5	0.5	0.2	-
Current ratio (x)	2.4	3.2	3.3	3.5
Interest cover (x)	30.3	43.4	63.0	104.2
<b>VALUATION</b>				
PE (x)	22.3	18.3	15.8	13.9
EV/ EBITDA (x)	15.1	12.8	10.8	9.3
EV/ Net sales (x)	3.5	3.1	2.7	2.3
PB (x)	6.4	5.0	3.8	3.0
Dividend yield (%)	0.3	0.3	0.3	0.3
Free cash flow yield (%)	0.8	1.1	5.3	6.1

Source: Company, Axis Capital

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