

Aurobindo Pharma

Performance Highlights

Y/E march (` cr)	2QFY19	1QFY19	% chg (QoQ)	2QFY18	% chg (yoy)
Net sales	4667	4182	11.6	4354	7.2
Other income	111	113	(1.8)	93	19.0
Operating profit	875	642	36.2	1036	(15.5)
Interest	35	30	19.8	17	104.9
Adj. Net profit	632	456	38.8	781	(19.1)

Source: Company, Angel Research

For 2QFY2019, Aurobindo Pharma (APL), the company posted sales of `4,667cr v/s. `4,354cr in 2QFY2018, a yoy growth of 7.2%. On the operating front, the EBITDA margin came in at 18.8% v/s. 23.8% in 2QFY2018. YoY decline is on the back of sales of certain high margin products in 2QFY18. Sequentially EBDITA margins expanded by ~340bp. Consequently, the Adj. PAT came in at `632cr v/s. `781cr in 2QFY2018, a yoy de-growth of 19.1%. **We recommend our accumulate rating on the stock.**

EBDITA Margins expands QoQ: On sales front, the company posted sales of `4,667cr v/s `4,354cr in 2QFY2018, posting a yoy growth of 7.2%. The formulation sales (`3,935cr) posted a yoy growth of 7.4%, while API (`817cr) posted a yoy growth of 5.8%. Europe & ROW (`1,464cr) posted a yoy growth of 7.9%, while company's key market USA (`2,227cr) posted a growth of 6.1% yoy. On the operating front, the EBITDA margin came in at 18.8% v/s. 23.8% in 2QFY2018. YoY decline is on the back of sales of certain high margin products in 2QFY18. Sequentially EBDITA margins expanded by ~340bp. Consequently, the Adj. PAT came in at `632cr v/s. `781cr in 2QFY2018, a yoy de-growth of 19.1%.

Outlook and valuation: We expect Aurobindo to report net revenue CAGR of ~20% & net profit to grow at ~17% CAGR during FY2018-20E, due to increased R&D expenditure. However, valuations of the company are cheap V/s its peers and own fair multiples of 17-18x. **We recommend a Accumulate rating on the stock.**

Key financials (Consolidated)

Y/E March (` cr)	FY2017	FY2018	FY2019E	FY2020E
Net sales	14,845	16,233	18,701	23,472
% chg	8.3	9.4	15.2	25.5
Adj. Net profit	2,302	2,423	2,641	3,329
% chg	13.7	5.3	9.0	26.1
EPS (`)	39.4	41.5	45.2	57.0
EBITDA margin (%)	21.5	21.6	20.9	20.8
P/E (x)	19.8	18.8	17.3	13.7
RoE (%)	27.6	23.0	20.6	21.5
RoCE (%)	23.1	20.6	19.3	22.5
P/BV (x)	4.9	3.9	3.3	2.7
EV/Sales (x)	3.3	3.0	2.6	2.0
EV/EBITDA (x)	15.1	14.0	12.4	9.8

Source: Company, Angel Research; Note: CMP as of November 16, 2018

ACCUMULATE

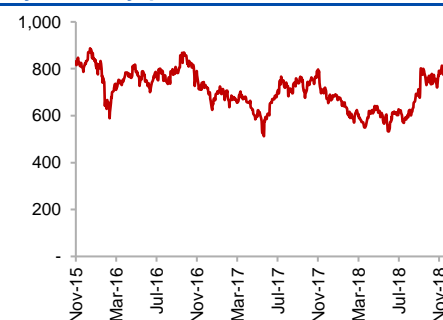
CMP	`780
Target Price	`855
Investment Period	12 months

Sector	Pharmaceutical
Market Cap (` cr)	45,715
Net debt (` cr)	3,265
Beta	1.3
52 Week High / Low	895/504
Avg. Daily Volume	67,116
Face Value (`)	1
BSE Sensex	35,457
Nifty	10,682
Reuters Code	ARBN.BO
Bloomberg Code	ARBP@IN

Shareholding Pattern (%)	
Promoters	51.9
MF / Banks / Indian FIs	18.4
FII / NRIs / OCBs	19.7
Indian Public / Others	10.0

Abs. (%)	3m	1yr	3yr
Sensex	(6.4)	7.1	37.6
Aurobindo	27.8	9.4	(4.9)

3-year daily price chart



Source: Company, Angel Research

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Exhibit 1: 2QFY2019 performance (Consolidated)

Y/E March (₹ cr)	2QFY2019	1QFY2019	% chg (QoQ)	2QFY2018	% chg (yoy)	1HFY2019	1HFY2018	% chg (yoy)
Net sales	4,667	4,182	11.6	4,354	7.2	8,849	7,975	11.0
Other income	111	113	(1.8)	93	19.0	224	174	28.4
Total income	4,778	4,294	11.3	4,447	7.4	9,072	8,149	11.3
Gross profit	2,624	2,274	15.4	2,586	1.5	4,899	4,713	3.9
Gross margins	56.2	54.4		59.4		55.4	59.1	
Operating profit	875	642	36.2	1,036	(15.5)	1,518	1,815	(16.4)
OPM (%)	18.8	15.4	22.1	23.8		17.1	22.8	
Interest	35	30	19.8	17	104.9	65	34	90.2
Dep & amortisation	164	155	5.9	132	23.9	318	263	20.9
PBT	787	571	37.8	979	(19.7)	1,358	1,692	(19.8)
Provision for taxation	175	116	51.8	198	(11.4)	291	389	(25.2)
Net profit	611	456	34.2	781	(21.8)	1,067	1,299	(17.9)
Less : Exceptional items (gains)/loss	-	-		-		-	-	-
MI & share in associates	0	(0)		(0)		(0)	(0)	-
PAT after Exceptional items	611	456	34.2	781	(21.7)	1,067	1,300	(17.9)
Adjusted PAT	632	456	38.8	781	(19.1)	1,088	1,300	(16.3)
EPS (₹)	10.8	7.8		13.3		18.6	22.2	

Source: Company, Angel Research

Revenue up 7.2% yoy; driven by formulations: On sales front, the company posted sales of ₹4,667cr v/s ₹4,354cr in 2QFY2018, posting a yoy growth of 7.2%. The formulation sales (₹3,935cr) posted a yoy growth of 7.4%, while API (₹817cr) posted a yoy growth of 5.8%. Europe & ROW (₹1,464cr) posted a yoy growth of 7.9%, while company's key market USA (₹2,227cr) posted a growth of 6.1% yoy. Overall, formulations now contribute around 82.8% of sales, while the balance is accounted by APIs.

The formulation sales (₹3,935cr) posted a yoy growth of 7.4%. Within which US business contributed 46.9% to the gross sales. On a constant currency basis, sales declined by 2.6% YoY. The decline is on back of a high base, which included higher sales of Renvela. US accounted for 46.9% of total revenues. The company filed 25 ANDAs with USFDA including 8 ANDAs for injectable products. Received final approval for 13 ANDAs and tentative approval for 2 ANDAs. The company has 510 approved ANDAs including 29 tentative approvals. In Euro terms, sales declined by 3.6% YoY. As on 30th September 2018, it has transferred manufacturing of 97 products from Europe to India. Company has maintained its guidance of 2x Industry growth (0-5%) rate in the EU market.

ARV business sales increased by 17.6% YoY to ₹244cr compared to ₹207.5cr in Q2FY18 and accounted for 5.1% of revenues. Sales from growth markets formulations posted a strong growth of 26.3% YoY to ₹307.5cr in 2QFY2019 and accounted for ~6.5% of revenues.

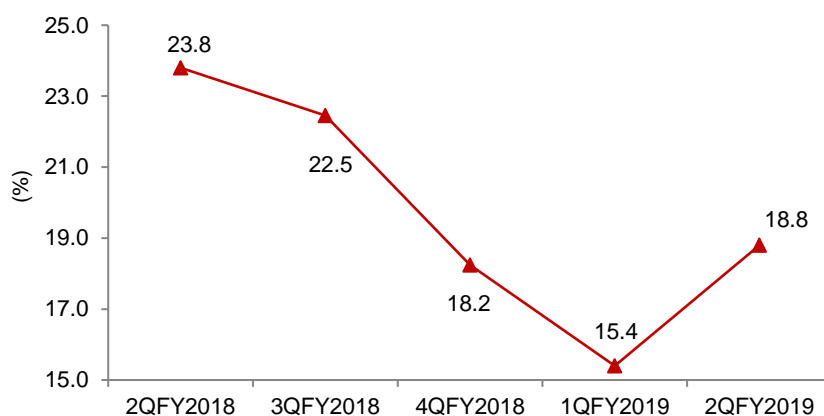
API business posted a growth of 5.8% to ₹816.6cr & contributed 17.2% of the total revenue during the quarter. The growth was on the back of increase in Non-Betalactum segment. The company filed 4 DMFs with USFDA during the quarter taking total DMFs filing to 235 as on 30th Sep 2018.

Exhibit 2: Sales break-up (Consolidated)

(` cr)	2QFY2019	1QFY2019	% chg (qoq)	2QFY2018	% chg (yoy)	1HFY2019	1HFY2018	% chg
Formulations	3935	3501	12.4	3663	7.4	7436	6714	10.7
US	2227	1890	17.8	2099	6.1	4116	3794	8.5
Europe & ROW	1464	1456	0.6	1357	7.9	2920	2468	18.3
ARV	244	156	56.8	208	17.6	400	452	(11.6)
API	817	748	9.2	772	5.8	1565	1397	12.0
SSP	513	492	4.4	514	(0.2)	1005	923	8.9
Cephs	303	256	18.4	258	17.7	559	474	18.0
Total Sales	4751	4249	11.8	4438	7.1	9000	8111	11.0

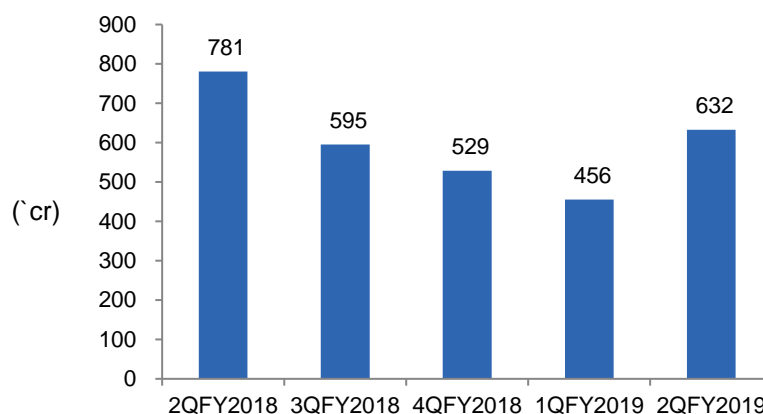
Source: Company, Angel Research

OPM comes in at 18.8%; QoQ expansion: On the operating front, the EBITDA margin came in at 18.8% v/s. 23.8% in 2QFY2018. YoY decline is on the back of sales of certain high margin products in 2QFY18. Sequentially EBDITA margins expanded by ~340bp. Employee cost and R&D cost increased (up ~150bp/ ~100bp YoY, as % of sales), respectively. This was partially offset by lower other expenses by 200bp (as % of sales). Research & Development (R&D) spend at `216.8cr, 4.6% of sales. In addition, during the quarter, the company had posted Forex losses of `39.7cr; adjusting which EBDITA margins would have been 19.6%.

Exhibit 3: OPM Trend


Source: Company, Angel Research

Consequently, net profit dips: Consequently, the Adj. PAT came in at `632cr v/s. `781cr in 2QFY2018, a yoy de-growth of 19.1%. Tax as a percentage of PBT was 22.3% v/s 20.2% of PBT in 2QFY2018.

Exhibit 4: Adj. net profit


Source: Company, Angel Research

Management takeaways

- In US adjusting for potential launches in 2QFY2018, the price erosion has been to the extent of 5-6% QoQ price erosion.
- Company is confident of growing 30% in FY2019 in the Injectables segment, with ramp up of Ertapenem, and launch of new products, including Vancomycin.
- Specifically, injectable sales stood at US\$50mn/US\$86mn in 2QFY2019/1HFY2019.
- It has acquired DPI inhalation asset from Advent Pharma for US\$12.5mn. The product is ready for starting clinical trials. Aurobindo guided to file product for the US market in 2020-21.
- Company has guided for strong pace of filings over the next 4-5 years.
- It maintained its guidance of closing the Sandoz deal in 1QFY2020.
- Aurobindo Pharma reduced debt by ~US\$20mn during the quarter, and guided for further debt reduction to US\$450mn (US\$551mn currently).

Recommendation rationale

- **Well placed for challenging times in USA:** Aurobindo has a robust pipeline (has filed 510 ANDA's; second highest amongst Indian companies) & is investing to enhance its foray into complex generic (mainly injectables, ophthalmic etc.) & biosimilar, which will drive its next leg of growth. In the current price competitive market, company is well placed; given it is vertically integrated with 70% of raw material requirements being met through internally. In addition, almost no single product of the company contributes than 3% of sales; unlike others peers, who have high product concentration. This is also evident from the performance of the company in USA in FY2018. Company expects pricing pressure to stabilize at +/- 5% yoy over the medium term. The company expects to launch ~30-40 products in the US, over the next six months, which will aid growth in the US business.

During 2QFY2019, Aurobindo Pharmaceuticals (APL) has acquired dermatology and oral solids businesses from Sandoz Inc., USA for an upfront purchase price of US\$0.9bn in cash. With this acquisition, Aurobindo adds

sales of US\$0.9bn and would become the 2nd largest generic player in the US by number of prescriptions. Acquisition is funded by debt and values the acquired company at 1.0xEV/sales, which we believe given the size and scope of the business acquired is very attractive. The transaction will lead to net debt to Equity reaching almost 0.6x FY2020E numbers and fully reflect in the FY2021 financials. The acquired business, as guided by the Management has EBDITA margins in line with APL (20-22%), making the deal attractive in terms of payback also. Transaction is expected to be accretive to normalized EPS from first full year of ownership. Overall USA will grow at 25.1% CAGR over FY2018-20E.

- Europe to grow steady, while ARV could provide extra boost:** Europe, which is another key region for the company, is expected to post CAGR of 20.0% during FY2018-20E, while ROW is expected to post a CAGR of 18.0% during same period. However, growth during the period would be more predominate in the ARV segment, where company has confirmed tenders of US\$80-100mn to be executed over next two years.

Outlook and valuation

We expect Aurobindo to report net revenue CAGR of ~20% & net profit to grow at ~17% CAGR during FY2018-20E, due to increased R&D expenditure. However, valuations of the company are cheap V/s its peers and own fair multiples of 17-18x. **We recommend accumulate rating on the stock.**

Exhibit 5: Key assumptions

	FY2019E	FY2020E
Sales Growth (%)	15.2	25.5
Operating Margins (%)	20.9	20.8
Capex ('cr)	1,388	1,200

Source: Company, Angel Research

Company background

Aurobindo Pharma manufactures generic pharmaceuticals and APIs. The company's manufacturing facilities are approved by several leading regulatory agencies like the USFDA, UK MHRA, WHO, Health Canada, MCC South Africa and ANVISA Brazil among others. The company's robust product portfolio is spread over six major therapeutic/product areas encompassing antibiotics, antiretrovirals, CVS, CNS, gastroenterological, and anti-allergics. The company has acquired the generic business of Actavis, which has made it a US\$2bn company and a leading company in Europe. With this acquisition, formulations now contribute around 83% to the company's sales (as in FY2018).

Profit & loss statement (Consolidated)

Y/E March (` cr)	FY2015	FY2016	FY2017	FY2018	FY2019E	FY2020E
Gross sales	12,221	13,937	15,084	16,493	18,986	23,830
Less: Excise duty	178	227	239	260	285	357
Net Sales	12,043	13,710	14,845	16,233	18,701	23,472
Other operating income	77	245	245	267	267	267
Total operating income	12,121	13,955	15,090	16,500	18,968	23,739
<i>% chg</i>	49.6	15.1	8.1	9.3	15.0	25.2
Total Expenditure	9,557	10,931	11,656	12,728	14,800	18,582
Net Raw Materials	5,506	6,162	6,434	6,753	7,761	9,976
Other Mfg costs	1,204	1,371	1,484	1,623	1,870	2,347
Personnel	1,302	1,543	1,768	2,131	2,493	2,992
Other	1,545	1,856	1,969	2,222	2,676	3,267
EBITDA	2,486	2,779	3,189	3,505	3,901	4,890
(% of Net Sales)	20.1	11.8	14.8	9.9	11.3	25.4
Depreciation & Amort.	333	392	428	558	678	769
EBIT	2,154	2,386	2,762	2,947	3,222	4,121
(% of Net Sales)	17.9	17.4	18.6	18.2	17.2	17.6
Interest & other Charges	84	93	67	78	75	55
Other Income	81	205	121	105	105	105
Recurring PBT	2,227	2,744	3,061	3,241	3,520	4,438
Tax	596.6	720.7	759.6	818.3	879.9	1109.6
(% of PBT)	27.5	26.3	24.8	25.2	25.0	25.0
PAT after MI (reported)	1,576	2,025	2,302	2,423	2,641	3,329
ADJ. PAT	1,576	2,025	2,302	2,423	2,641	3,329
<i>% chg</i>	21.5	25.1	13.7	5.3	9.0	26.1
Basic EPS (`)	27.7	34.6	39.3	41.4	45.1	56.9
<i>% chg</i>	21.5	25.1	13.7	5.3	9.0	26.1

Balance sheet (Consolidated)

Y/E March (` cr)	FY2015	FY2016	FY2017	FY2018	FY2019E	FY2020E
SOURCES OF FUNDS						
Equity Share Capital	29	59	59	59	59	59
Share Application Money	-	-	-	-	-	-
Reserves & Surplus	5,127	7,229	9,313	11,622	13,953	16,893
Shareholders Funds	5,156	7,287	9,372	11,680	14,012	16,951
Minority Interest	26	3	2	2	1	1
Long-term provisions	24	23	22	56	56	56
Total Loans	3,864	4,415	3,084	4,483	3,000	2,500
Deferred Tax Liability	211	(182)	(118)	76	76	76
Total Liabilities	9,280	11,546	12,362	16,297	17,089	19,529
APPLICATION OF FUNDS						
Gross Block	6,095	6,093	7,625	8,998	10,386	11,586
Less: Acc. Depreciation	1,794	2,186	2,614	3,172	3,850	4,619
Net Block	3,752	3,907	5,011	5,826	6,535	6,966
Capital Work-in-Progress	310	310	310	310	310	310
Goodwill	64	812	971	1,968	1,968	1,968
Investments	20	123	246	312	312	312
Long-term loans and adv.	486	269	338	343	343.32	395.52
Current Assets	8,279	10,294	9,206	12,188	12,978	16,301
Cash	469	834	513	1,262	392	507
Loans & Advances	8	831	409	10	10	10
Other	7,802	8,629	8,284	10,916	12,576	15,784.18
Current liabilities	3,634	4,168	3,720	4,649	5,356.17	6,723
Net Current Assets	4,645	6,127	5,487	7,539	7,622	9,578
Mis. Exp. not written off	5	-	-	-	-	-
Total Assets	9,280	11,546	12,362	16,297	17,089	19,529

Cash flow statement (Consolidated)

Y/E March (` cr)	FY2015	FY2016	FY2017	FY2018	FY2019E	FY2020E
Profit before tax	2,168	2,744	3,061	3,241	3,520	4,438
Depreciation	333	392	428	558	678	769
(Inc)/Dec in Working Capital	(757)	(1,333)	388	(1,298)	(953)	(1,790)
Less: Other income	81	205	121	105	105	105
Direct taxes paid	(597)	(721)	(760)	(818)	(880)	(1,110)
Cash Flow from Operations	1,066	877	2,996	1,577	2,260	2,203
(Inc.)/Dec.in Fixed Assets	(1,989)	3	(1,532)	(1,374)	(1,388)	(1,200)
(Inc.)/Dec. in Investments	-	103	123	66	-	-
Other income	81	205	121	105	105	105
Cash Flow from Investing	(1,908)	311	(1,288)	(1,203)	(1,282)	(1,095)
Issue of Equity	-	-	-	-	-	-
Inc./(Dec.) in loans	94	552	(1,331)	1,398	(1,483)	(500)
Dividend Paid (Incl. Tax)	(171)	(171)	(171)	(171)	(309)	(389)
Others	1,209	(1,204)	(527)	(854)	(56)	(104)
Cash Flow from Financing	1,133	(823)	(2,030)	373	(1,847)	(993)
Inc./(Dec.) in Cash	291	365	(321)	748	(869)	115
Opening Cash balances	179	469	834	513	1,262	392
Closing Cash balances	469	834	513	1,262	392	507

Key ratios

Y/E March	FY2015	FY2016	FY2017	FY2018	FY2019E	FY2020E
Valuation Ratio (x)						
P/E (on FDEPS)	28.2	22.5	19.8	18.8	17.3	13.7
P/CEPS	11.9	18.9	16.7	15.3	13.8	11.1
P/BV	4.4	6.3	4.9	3.9	3.3	2.7
Dividend yield (%)	0.6	0.3	0.3	0.3	0.6	0.7
EV/Sales	2.2	3.6	3.3	3.0	2.6	2.0
EV/EBITDA	10.5	17.7	15.1	14.0	12.4	9.8
EV / Total Assets	2.8	4.3	3.9	3.0	2.8	2.4
Per Share Data (₹)						
EPS (Basic)	27.7	34.6	39.3	41.4	45.1	56.9
EPS (fully diluted)	27.7	34.6	39.3	41.4	45.1	56.9
Cash EPS	65.4	41.3	46.6	50.9	56.7	70.0
DPS	4.5	2.5	2.5	2.5	4.5	5.7
Book Value	176.6	124.5	160.1	199.6	239.4	289.7
Dupont Analysis						
EBIT margin	17.9	17.4	18.6	18.2	17.2	17.6
Tax retention ratio	72.5	73.7	75.2	74.8	75.0	75.0
Asset turnover (x)	1.5	1.4	1.3	1.2	1.2	1.3
ROIC (Post-tax)	19.2	18.3	18.7	16.7	15.4	17.5
Cost of Debt (Post Tax)	1.6	1.7	1.3	1.5	1.5	1.5
Leverage (x)	0.8	0.6	0.4	0.3	0.2	0.2
Operating ROE	33.4	27.9	25.4	20.8	18.7	19.9
Returns (%)						
ROCE (Pre-tax)	25.3	22.9	23.1	20.6	19.3	22.5
Angel ROIC (Pre-tax)	27.6	26.5	27.4	25.3	23.7	26.4
ROE	36.4	32.5	27.6	23.0	20.6	21.5
Turnover ratios (x)						
Asset Turnover (Gross Block)	2.4	2.3	2.2	2.0	2.0	2.2
Inventory / Sales (days)	90	100	101	113	104	105
Receivables (days)	93	107	89	65	65	65
Payables (days)	98	126	119	114	112	112
WC cycle (ex-cash) (days)	119	124	124	124	130	125
Solvency ratios (x)						
Net debt to equity	0.7	0.5	0.3	0.3	0.2	0.1
Net debt to EBITDA	1.4	1.3	0.8	0.9	0.7	0.4
Interest Coverage (EBIT / Int.)	25.5	25.8	41.4	37.9	43.1	74.9

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1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15%)