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Initiating Coverage

Aurobindo Pharma Ltd

28 - September - 2020

RETAIL RESEARCH

Aurobindo Pharma Ltd

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Pharmaceuticals	Rs 772.1	Buy at the LTP and add on dips to Rs.673-677 band	Rs 861	Rs 921	2 quarters

HDFC Scrip Code	AURPHAEQNR
BSE Code	524804
NSE Code	AUROPHARMA
Bloomberg	ARBP: IN
CMP Sep 25, 2020	772.1
Equity Capital (Rscr)	58.6
Face Value (Rs)	1
Equity Share O/S (cr)	58.6
Market Cap (Rscr)	45230
Book Value (Rs)	287
Avg. 52 Wk Volumes	4829210
52 Week High	967.6
52 Week Low	281.2

Share holding Pattern % (Jun, 2020)	
Promoters	52
Institutions	35.2
Non Institutions	12.8
Total	100.0

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Our Take:

Aurobindo Pharma is a leading Indian pharmaceutical company with presence in the formulations as well as in API space. Company derives around 75% of the revenues from the developed markets of the US and Europe. Of late, regulatory pressures seem to easing a bit with US FDA clearing the Unit-IV, which had a sizeable chunk of products linked to it. Also, the company has been able to gain market share in the US, with the revenues clocking a strong double-digit growth for the Q1FY21; US revenues had registered strong 27% rise for FY20. Going ahead, the management expects the traction in the US business to continue backed by a strong product launch pipeline and easing of pricing pressure in the US generic space.

Its product pipeline focuses on oncology, hormones, biologics, derma, respiratory, depot injections, vaccine and peptides with addressable market of over US$100bn. An improving product mix should be visible starting FY22-23 and strengthen its margin profile in the long run. Company has requested US FDA to hold remote audits for Unit I/IX/XI and completed remediation for Unit VII. A successful resolution of US FDA observations would be a key monitorable and trigger for earnings upgrade. Profitability in EU has risen to double digit and should continue improving in H2FY21.

Over the long term, the company is looking to build a presence in the biosimilars space which is likely to support growth. Company has reduced its net debt by US$ 400mn over the past four quarters; it stood at US$ 191mn as on Jun-2020. We remain positive on Aurobindo on the thesis that i) strong execution track record exhibited by around 530bps increase in prescription share over the past 4 years in US generics space; 2) steady progress on a differentiated pipeline to drive long-term earnings sustainability; 3) turnaround of Apotex business will further drive margin expansion of EU business; and 4) strong FCF generation to aid in reducing leverage.

View & Valuation:

Aurobindo derives large part of its revenues from highly regulated market of the US and Europe. US revenues increased 27% yoy at Rs 11484cr for FY20 while it grew ~16% yoy for Q1FY21. Management expects the momentum to sustain backed by a strong new launch pipeline and stable price erosion in the generics space. Aurobindo's five plants are still under the US FDA scrutiny. The company has submitted responses and is waiting revert from the regulator. Europe business is also expected to improve gradually and gain traction. Company has reduced its net debt from US$ 593mn (Q1FY20) to US$ 191mn in Q1FY21. We estimate 9% revenues CAGR led by strong US business and 13% PAT CAGR over FY20-22E. Further, new approvals are key drivers for sustained growth, as the base business in the US is

fairly large. Hence, timely and proper resolution of the US FDA issues remains critical. Aurobindo's gradual improvement in portfolio mix towards differentiated and specialty products and rising spend on R&D deserves gradual rerating of its stock price. At CMP, the stock trades at ~12.7x FY22E earnings. We feel investors can buy the stock at the LTP and add on dips to Rs.673-677 band (11.0x FY22E EPS) for base case target of Rs 861 (14x FY22E EPS) and bull case target of Rs 921 (15x FY22E EPS).

Financial Summary

Particulars (Rs cr)	Q1 FY21	Q1 FY20	YoY (%)	Q4 FY20	QoQ (%)	FY19	FY20	FY21E	FY22E
Total Revenues	5925	5445	8.8	6158.4	-3.8	19,564	23,099	25,470	27,494
EBITDA	1317.4	1161	13.5	1343	-1.9	3952	4864	5461	5774
Depreciation	255.5	241	6.0	232.4	9.9	668	967	1044	1159
Other Income	93.4	15.8	491.1	32.6	186.5	116	192	231	270
Interest Cost	21	50	-58.0	31.8	-34.0	263	305	135	95
Tax	303.7	228	33.2	229	32.6	727	914	1149	1197
APAT	781	650	20.2	850	-8.1	2290	2831	3318	3596
EPS (Rs)						39.1	48.3	56.6	61.4
RoE (%)						18.6	18.4	18.2	16.6
P/E (x)						20.0	16.2	13.8	12.7
EV/EBITDA						12.8	10	8.6	7.7

(Source: Company, HDFC sec)

US business gradually improving

Aurobindo derives around 75% of the revenues from the developed markets of the US and Europe. It has rapidly grown its US sales from US$ 120mn in FY09 to ~US$ 1.6bn in FY20 (largely organic) on the back of several product launches and market share gains in the base portfolio. Of late, regulatory pressures seem to easing a bit with US FDA clearing the Unit-IV, which had a sizeable chunk of products linked to it. Also, the company has been able to gain market share in the US, with revenues clocking a strong double-digit growth for the quarter. Going ahead, the management expects the traction in the US business to continue backed by strong products launch pipeline and relatively easing of pricing pressures in the US generic markets. However, the company is yet to get US FDA clearance for five of its plants and so new product approvals from plants are held up. A successful resolution from US FDA would lead to further growth. Over the long term, Aurobindo is looking to build a presence in the biosimilars space which is likely to support growth.

In April-2020, Aurobindo Pharma received EIR from US FDA and VAI status for its injectable formulation facility, unit IV. The clearance of this unit released major potential earnings overhang as well. We expect ANDA approvals from this plant should flow through and project better injectable segment growth going ahead. Unit IV is one of the most critical plants from an organic growth perspective for the company. Also, the margin profile of injectable segment is expected to be superior than the company average. Now the company is running with OAI status on unit VII (apart from previous OAI on unit XI (has received WL), IX and I). The recent Covid-19 outbreak scenario may offer some further opportunity to base products in US along with probable API opportunities.

Injectables - the key growth driver

Aurobindo ranks second in the US generic injectables market in terms of units share as of Dec 2019. It has a comprehensive injectables portfolio (122 filed and 49 pending ANDAs) and is best placed to capitalize on the growth opportunities led by drug shortages and increased demand. Additionally, resolution of Unit IV (largest injectables facility) gives confidence on growth as it paves way for future approvals. The pending ANDAs and future filings comprise of bigger share of complex opportunities viz. oncology, hormonal, liposomes, microspheres, depot injectables, peptides which will improve product mix and profitability.

Branded presence through Spectrum acquisition

Aurobindo acquired seven brands of Spectrum in oncology segment in Jan-2019. The acquisition provides presence in the branded segment and a platform to launch oncology products in future. The seven brands (~US$ 110mn) account for around 7% of US revenues in FY20. We expect one new launch over the next two years.

Strong US pipeline augurs well for future growth

Aurobindo has a large basket of products in the US with 438 ANDA approvals (including tentative ones) and 166 ANDAs awaiting approval. The addressable market size of pending ANDAs is ~US$ 87bn. Almost 40% of the filings are complex in nature. Company has filed around 215 ANDAs over the last five years, which accounts for 4.4% of total ANDAs filed with USFDA. We expect Aurobindo's R&D costs to increase by 100-150bps over the next two years as it continues to invest in complex/niche products like oncology/hormones, peptides, topicals, transdermals and also in differentiated technology platforms of depot injectables, inhalers, patches and films.

Oncology & Hormones

Aurobindo's JV-Eugia's product portfolio comprises 84 products that are prescribed for oncology, hormone and immunosuppressant indications. During FY20, it filed 12 ANDAs for USA, of which nine were injectables. Eugia also filed 11 dossiers for other markets, of which 8 were injectables. Eugia filed a total of34 ANDAs and received approval for 13products, including tentative approvals for 3 ANDAs as on 31 March 2020.The market size of Eugia's 74 oncology products, which are under development, stands close to US$ 40 billion. These products have applications across prostate cancer, lung cancer, multiple myeloma, metastatic melanoma, Hodgkin's lymphoma, acute myeloid leukemia, sickle cell disease and thrombocythaemia. Current hormonal portfolio includes 10 products with market size of US$ 1.1bn. The hormonal products are prescribed for indications involving preterm birth, birth control, amenorrhea and hypogonadism.

Balance sheet strengthened further; net debt stood at US$ 191mn

Net debt was reduced further by US$168mn during Q1FY21 (in addition to US$ 365mn reduction in FY20). Aurobindo is on track to achieve its debt reduction guidance of US$ 200-250mn in FY21 and is targeting to be debt-free by FY22 - note that this is mainly operational led and management alluded that utilization of factoring has come off in the last two quarters. Receivables days have also declined sharply during the quarter (at 49 days, -16 days qoq), driven by better collections in the US.

Europe Business

Company registered 19.4% growth in its Europe formulations business, as revenue touched Rs 5922cr in FY20 compared to Rs 4960cr in FY19 on account of an increased portfolio of offerings. Company reported healthy performance in Spain, UK, Italy, Netherlands and France. The integration of Apotex Inc.'s businesses with Aurobindo, has strengthened its presence in Europe. Company operates in 11 countries and is present across multiple channels including pharmacy (Rx), hospital (Hx) and tender (Tx). Company's focus will remain on filing more products on a consistent basis, diversifying its existing product portfolio, reaching out to critical markets, and streamlining of sales, marketing and channels of operation.

Apotex turnaround to drive Europe margins higher

Aurobindo has been expanding its European footprint since 2006 both organically and via acquisitions. The company has presence in generics, tender business, branded generics and hospitals segments. It ranks among the top 10 generics companies in 4 out of the top 5 EU countries. France and Germany are the top 2 markets. The recent acquisition of the Apotex business deepened Aurobindo's presence in existing markets of Spain, the Netherlands and Belgium and provides entry into newer markets of Poland and Czech Republic. The portfolio

includes 200 Rx and 88 OTC products. The pipeline includes 20 launches in the next two years. We expect the business to post 10% CAGR over FY20-22E driven by increased market access, market share gains in own and acquired portfolio and new launches. EBITDA margins is expected to expand led by: 1) lowering COGS by transferring products to Aurobindo's own manufacturing in India; 2) operational synergies through combined business infrastructure; and 3) ramp-up in own filings and day-one launches.

ARV & Growth markets business

Aurobindo is one of the largest players in the ARV segment (32 products) catering to over 125 countries. It is well integrated in terms of supply chain. It has filed more than 1,100 ARV dossiers across the globe. However, the business declined by 1% over FY16-20 owing to capacity constraints and exits in low margin business. We expect ARV business to register ~8% CAGR in FY20-22E driven by a ramp-up in DTG (Dolutegravir) sales.

Company's formulations sales in growth markets including Brazil, Canada, Columbia and South Africa grew by 13.5% yoy to Rs 1355cr. In Canada, it is the eighth largest generic company in terms of value for the 12 months ended March 2020 as per IQVIA data. During the year, company has launched 13 products and submitted dossier filings for 13 products.

Aurobindo Sandoz Deal Called off

Aurobindo and Sandoz Inc. mutually announced the termination of the deal that the company was buying US generic oral solids and dermatology businesses from Sandoz. The primary reason identified was failure to obtain the required transaction approval from the US Federal Trade Commission (FTC) during anticipated timelines. The deal meant revenues of nearly US$ 750-850mn with operating profit margin at 27%. The impact on earnings would be lower due to depreciation charge and interest cost.

COVID-19 opportunity

Aurobindo has joined hands with Council of Scientific and Industrial Research (CSIR) for developing a COVID-19 vaccine. Also, independently, through its US subsidiary, Auro Vaccines, it is developing a COVID-19 vaccine. Successful development and approval of the vaccine could unlock large growth avenues.

Q1FY21 Key Highlights

- Injectable sales were down to US$ 51mn as compared to US$ 59mn in Q4FY20 due to a reduction in hospital sales (impacted by Covid-19). However, it is gradually improving and the company expects Q2 sales to be better than that of Q1.
- For Unit-I, IX & XI, the company has completed all CAPAs and has requested for desktop audit. For Unit-7, the company has almost completed all CAPAs and is awaiting further direction from the US FDA.
- For the US market, the company has guided ~50 launches this fiscal. 80-90 injectables products are in various stages of development. An injectable plant also coming up in Vizag.
- The company filed for 14 ANDAs during the quarter (3 injectables) and received 10 approvals. It launched six products, including 1 injectable in the US during Q1 FY21. API sales saw moderate growth as 50-55% of API sales is from antibiotics where demand has been muted.
- In the ARV segment, the switch from TLE combination to TLD has aided growth. Company expects one filing in biosimilar in Europe by Q4FY21.
- Net debt further came down by US$ 168mn qoq to US$ 191mn. Company has been reducing debt for the last 3-4 quarters. Collections have been really good in the last two months. Debtor days have reduced to 49 from 65 in Mar-20. Cash on hand stood at US$ 441mn as on Jun-2020.
- Blended finance cost stood at 1.5%, mainly on account of availing multiple currency loans.
- There was healthy FCF generation of US$ 217mn (before capex) during the quarter. The company has guided for US$150-200mn in capex for FY21.
- Currently, R&D as % of sales stands at 4.3%, of which 35% is spent on specialty. Company expects R&D expense to increase in FY21 (+5% of sales), as it will start clinical trials for biosimilar and other complex products.
- Company has launched 34 products during FY20. The Rx share in the US has increased to 8.5% for 12 months ending April 2020 as compared to 7% for 12 months ending April 2019, as per IQVIA data.
- Company has filed a total of 134 injectable ANDAs as on June, 2020, out of which 75 have received final approval and the balance are under review.
- Aurobindo is also interested in participating in the Indian government's PLI scheme for API localization, as it is witnessing a rise in demand for many molecules in its portfolio, and has a strong antibiotics presence as well.

Key Risks/Concerns

- Delay in product approvals in US market
- Change in regulatory landscape; and negative outcome of key facility inspections by the US FDA may affect earnings prospects.
- Lower than expected contribution from new launches in the US
- Slower than expected improvement in the EU portfolio
- Company may have an adverse/favorable impact on earnings on currency fluctuations as company derives significant part of revenues from international business.
- The R&D scale-up on complex filings will likely play out from FY24. Also its inhalation and biosimilars (Avastin filing for the EU in Q1FY22) products are yet to be filed, with meaningful profit contribution unlikely before FY24.
- A decline in ARV sales due to funding squeeze by sponsors or other external factors
- A delay in recovery of sales from COVID-19 disruptions and a failure to scale up US sales including injectables sales
- US DOJ penalties around alleged price collusion.

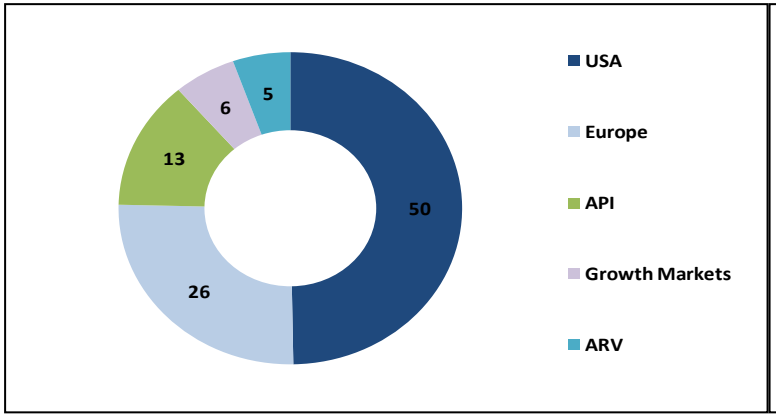
Company Background

Aurobindo Pharma was incorporated in 1986 and manufactures generic formulations and active pharmaceutical ingredients (APIs). Aurobindo generates > 90% of its sales from international markets. The company 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. It is a vertically integrated company, meeting around 70% of its API requirements in-house. Aurobindo has 29 manufacturing facilities for its API and formulations businesses, which have requisite approvals from various regulatory authorities, including the US FDA, UK MHRA, Japan PMDA, WHO, Health Canada, MCC South Africa and ANVISA Brazil. Company 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.

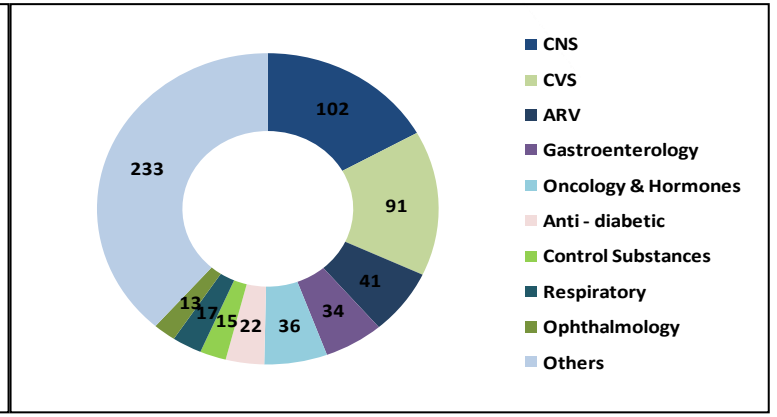
Aurobindo has one of the best product approval rates and launch pipelines in the US. Despite pricing pressures, the company is one of the few companies able to mitigate this risk due to continuous product launches and approvals. The company is grappling through US FDA scrutiny at its various plants.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

Aurobindo Pharma Ltd

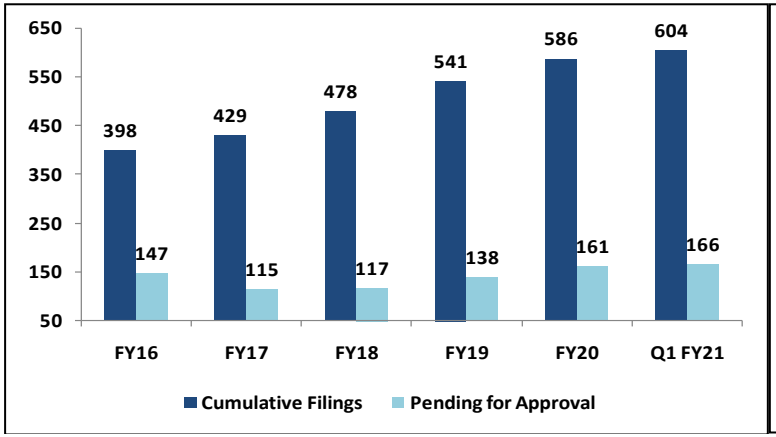
Revenues Split (%)



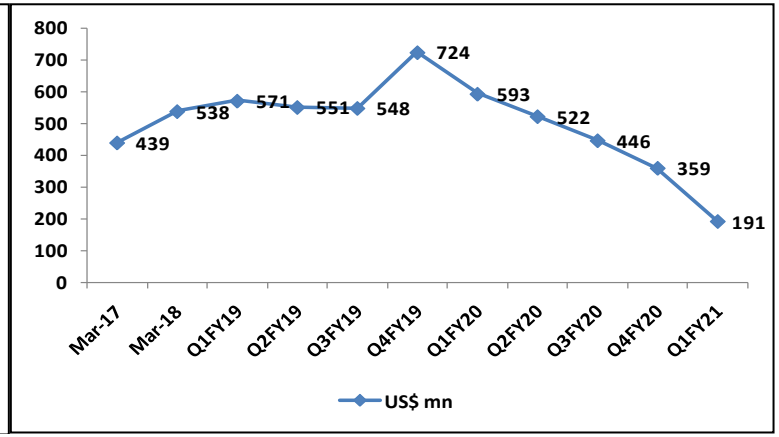
ANDA Filings (#)



ANDA Filings and Approvals Trend (#)



Net Debt at comfortable levels



Source: Company, HDFC sec Research

Aurobindo Pharma Ltd

Income Statement

(Rs Cr)	FY18	FY19	FY20	FY21E	FY22E
Total Revenues	**16500**	**19564**	**23099**	**25470**	**27494**
Growth (%)	10.4	18.6	18.1	10.3	7.9
Operating Expenses	12711	15612	18235	20009	21720
EBITDA	**3789**	**3952**	**4864**	**5461**	**5774**
Growth (%)	9.6	4.3	23.1	12.3	5.7
EBITDA Margin (%)	**23**	**20.2**	**21.1**	**21.4**	**21**
Depreciation	558	668	967	1044	1159
EBIT	3231	3284	3897	4417	4615
Other Income	102	116	192	231	270
Exceptional Items	-17	-123	-26	-38	0
Interest expenses	78	263	305	135	95
PBT	3238	3014	3758	4475	4790
Tax	818	727	914	1149	1197
RPAT	**2423**	**2290**	**2831**	**3318**	**3596**
Growth (%)	5.3	-5.5	23.6	17.2	8.4
EPS	**41.3**	**39.1**	**48.3**	**56.6**	**61.4**

Balance Sheet

Year to March	FY18	FY19	FY20	FY21E	FY22E
Share Capital	58.6	58.6	58.6	58.6	58.6
Reserves & Surplus	11622	13832	16752	19859	23245
Shareholders' Equity	**11681**	**13891**	**16811**	**19918**	**23304**
Long Term Loans	451	180	0	0	0
Short Term Loans	4319	6786	5562	4062	2750
Total Loans	4770	6966	5562	4062	2750
Defered tax liabilities (net)	235	281	303	303	303
Total Equity & Liabilities	**16688**	**21140**	**22675**	**24282**	**26354**
Application of Funds					
Net Block	6704	8801	9761	10217	10558
CWIP	1400	1342	1622	1622	1622
Current Assets	**12363**	**15539**	**16626**	**19221**	**21597**
Inventories	5858	7246	7700	9421	10169
Debtors	3084	3414	4315	4745	5122
Cash & Bank Balance	1262	1957	2842	3265	4493
Loans & Advances	2159	2922	1769	1790	1814
Current Liabilities	**4418**	**5315**	**6251**	**7696**	**8340**
Provisions	1790	2637	3355	3648	3971
Net Current Assets	7946	10224	10375	11525	13257
Total Assets	**16688**	**21140**	**22675**	**24282**	**26354**

Source: Company, HDFC sec Research

Aurobindo Pharma Ltd

Cash Flow Statement

(Rs Cr)	FY18	FY19	FY20	FY21E	FY22E
PBT	3241	3091	3743	4476	4789
Depreciation and Amortisation	558	668	967	1044	1159
Other Non Cash Items	**-23**	**146**	**124**	**126**	**99**
Cash Flow before W/C Changes	3776	3905	4834	5645	6048
Change in W/C	-1069	-1485	251	-728	-504
Taxes Paid	-752	-770	-730	-1149	-1197
Operating Cash Flows	3096	1411	363	2641	2485
Change in Fixed Assets	**-1819**	**-1581**	**-1450**	**-1500**	**-1500**
Others	-138	-1321	-118	0	0
Investing Cash Flows	-1957	-2903	-1568	-1500	-1500
Equity Capital issuance	0	0	0	0	0
Borrowings	**1202**	**2230**	**-1530**	**-1500**	**-1313**
Interest paid	-74	-152	-127	-135	-95
Dividend Paid	-264	-160	-188	-211	-211
Financing Cash Flows	895	1919	-1947	-1846	-1619
Change in cash & equivalents	892	667	841	423	1227
Free Cash Flow	**-607**	**296**	**1266**	**1765**	**2993**

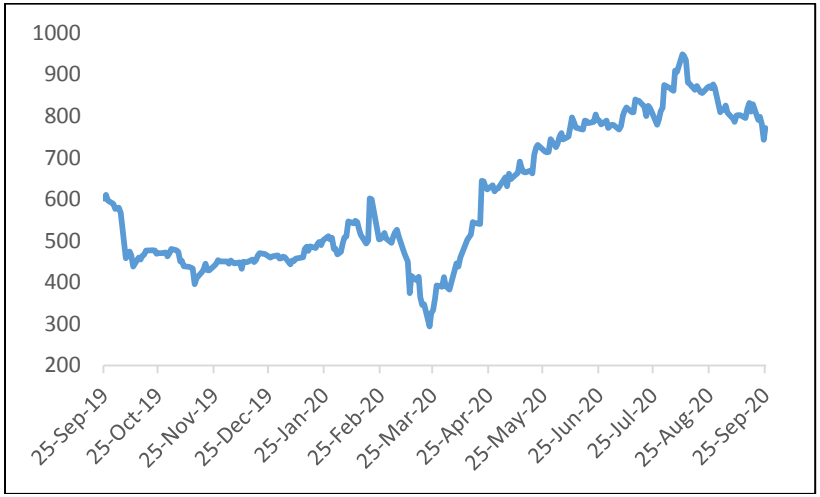
Key Ratios

	FY18	FY19	FY20	FY21E	FY22E
EBITDA Margin	23	20.2	21.1	21.4	21
EBIT Margin	19.6	16.8	16.9	17.3	16.8
APAT Margin	14.8	12.1	12.3	13.1	13.1
RoE	23	18.6	18.4	18.2	16.6
RoCE	17	13.6	14	14.7	14.5
Solvency Ratio					
Net Debt/EBITDA (x)	0.9	1.3	0.6	0.1	-0.3
Interest Coverage	42	13	13	33	48
Net D/E	0.3	0.4	0.2	0	-0.1
PER SHARE DATA					
EPS	41.3	39.1	48.3	56.6	61.4
CEPS	52.8	24.1	6.2	45.1	42.4
BV	199	237	287	340	398
Dividend	3	3	3	3	3
Turnover Ratios (days)					
Debtor days	68	68	69	68	68
Inventory days	130	130	122	135	135
Creditors days	58	50	40	58	58
VALUATION					
P/E	19	20	16.2	13.8	12.7
P/BV	3.9	3.3	2.7	2.3	2
EV/EBITDA	13	12.8	10	8.6	7.7
EV / Revenues	3.1	2.7	2.2	2	1.7

Source: Company, HDFC sec Research

Aurobindo Pharma Ltd

One Year Price Chart



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