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Stock Update

Aurobindo Pharma Ltd.

23-August-2021

RETAIL RESEARCH

Aurobindo Pharma Ltd.

Industry	LTP	Recommendation	Revised Fair Value (Base case and Bull case)	Time Horizon
Pharmaceuticals	Rs 681.1	Fresh investors can buy at the CMP and add on dips to Rs. 615-625 band	Rs 738 and Rs 797	2 quarters

HDFC Scrip Code	AURPHAEQNR
BSE Code	524804
NSE Code	AUROPHARMA
Bloomberg	ARBP IN
CMP Aug 20, 2021	681.1
Equity Capital (Rs cr)	58.6
Face Value (Rs)	1
Equity Share O/S (cr)	58.6
Market Cap (Rs cr)	39928
Book Value (Rs)	374
Avg. 52 Wk Volumes	4822351
52 Week High	1063
52 Week Low	678

Share holding Pattern % (Jun, 2021)	
Promoters	51.8
Institutions	38.4
Non Institutions	19.8
Total	100.0

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Our Take:

Aurobindo's revenue/EBITDA missed estimates in Q1FY22 primarily on account of muted US sales (-7% QoQ) and ARV business (-30% YoY). The price erosion in the US was in high single digit, but this would normalise, going forward (H2FY22). US pipeline provides good growth visibility with assets across injectables, biosimilars, vaccines and OTC products. On the regulatory front, while few plants still remain under the US FDA scrutiny, the erstwhile clearance of a critical plant (Unit IV) indicates that the company continues to work towards regulatory compliance. US generics scenario continues to witness price erosion and slower injectables ramp-up. Potential value unlocking of the injectables business and resolution of US FDA facilities are the key near-term triggers for the stock.

We have reduced our estimates to factor in the higher price erosion and lower multiple. Considering: a) complex products in the development phase, and b) sale of the Natrol business, we expect low single digit CAGR in US sales over FY21-23E.

On April 23, 2021, we had re-initiated coverage on Aurobindo for the base case target of Rs 1104 and bull case target of Rs 1168. (https://www.hdfcsec.com/hsl.research.pdf/Re-Initiating%20Coverage%20-%20Aurobindo%20Pharma_230421.pdf) Weak US business growth coupled with price erosion issues in the US generics market, would overshadow monetization of its injectables business are the key reasons for our downgrade.

Valuation & Recommendation:

Weak outlook for the US market due to higher price erosion, makes us reduce estimates, downgrade rating and cut multiple for the stock. After turning net cash, the company has been focusing on scaling-up its investments across multiple fronts like biosimilars, injectables and APIs which are likely to contribute from FY23/24 onwards. Also in the long term, Aurobindo is looking to build a presence in the specialty segment, including biosimilars, oncology inhalers, and transdermal patches, which are likely to drive growth in the next 3-4 years. As a result, immediate triggers for earnings growth for the company looks weak, given pricing erosion in the US portfolio and slower ramp up in the injectables. Capital allocation concerns come back into focus (though the Cronus Pharma deal has been cancelled) and will act as an overhang. Progress across other fronts including biosimilars/complex injectables are yet to pick pace. Aurobindo's near-term pressure from Ertapenem competition and high-single-digit price erosion is likely to be offset by a pipeline of ~170 pending ANDAs, 50 annual

launches, gRevlimid settlement and injectable expansion. We cut Revenue/EBITDA/PAT estimates by 3.5%/6%/8% for FY22 and 1%/6%/9% for FY23. Now, we estimate 5% CAGR in sales, led by both US and EU business, over FY21-23E.

We expect 4.4%/2.5% CAGR in EBITDA/net profit over the same period. We have revised base case target to Rs 738 (based upon 12.5x FY23E EPS) and bull case target at Rs 797 (13.5x FY23E EPS).

Any positive outcome related to vaccine, stronger than expected growth in the Injectables business and demerger of Injectables business could remain upside triggers for the stock.

Quarterly Financials

Particulars (Rs cr)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Total Revenues	5702	5925	-3.8	6002	-5.0
EBITDA	1209	1257	-3.8	1275	-5.1
Depreciation	280	256	9.4	266	5.3
Other Income	110	116	-5.2	78	41.0
Interest Cost	13	21	-38.1	18	-28.6
Tax	248	304	-18.4	260	-4.6
APAT	770	783	-1.7	801	-3.9
EPS (Rs)	13.1	13.3	-1.7	13.7	-3.9

(Rs cr)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Formulations	**4890**	**5145**	**-5.0**	**5211**	**-6.2**
US	2681	3107	-13.7	2856	-6.1
Europe	1583	1322	19.7	1553	1.9
ARV	296	426	-30.5	491	-39.7
RoW	329	290	13.4	306	7.5
API	**812**	**780**	**4.1**	**794**	**2.3**

(Source: Company, HDFC sec)

Q1FY22 result update

- Reported revenue declined 3.8% YoY at Rs 5702cr. Adjusted for Natrol, overall revenue grew 3% YoY. EBITDA margin remained flat YoY at 21.2%. Net profit declined 1.7% YoY at Rs 770cr on lower revenues. During FY21, the company had divested the Natrol business.
- Adjusted US formulations revenue declined 1.5% YoY at Rs 2681cr. The US business saw a sequential decline in revenue due to higher stocking at the distributor level.
- Europe formulation revenue grew 20% YoY at Rs 1583cr. API revenue grew 4% YoY at Rs 812cr. Company derived 92% of revenue from international markets while India contributed to 8% of revenue in Q1FY22. Research & Development (R&D) spend for the quarter stood at Rs 358cr or 6.3% of revenue.
- Company filed 8 ANDAs including 2 injectables with US FDA in Q1FY22. It received final approval for 4 ANDAs including 3 injectables. As on Jun-2021, on a cumulative basis, the company filed 654 ANDAs with US FDA and received approval for 480 ANDAs including 29 tentative approvals. The company launched 5 products including 2 injectables.

Concall highlights

- Company had registered injectable sales of US$ 395mn in FY21. Target of injectable of achieving US$ 600-700mn over the next 2-3 years remain intact. Global injectable sales for the quarter was at US$ 102mn.
- Constant currency US sales stood at ~US$ 364mn. Gross margin was lower due to change in the product mix.
- Aurobindo has recently allocated ~US$ 160mn for acquisition in the Veterinary space and adding ANDAs in the US generics market.
- Company purchased nine OTC products and six ANDAs as the opportunities were cost beneficial for portfolio expansion. Management expects US$ 30-35mn from OTC brands, with revenue contribution not present in Q1. They expect US$ 30mn per annum from ANDAs.
- US business witnessed high single digit price erosion in Q1FY22 which was higher than usual.
- Aurobindo filed eight ANDAs including two injectables with US FDA in Q1FY22. It received final approval for four ANDAs including three injectable in Q1FY22.
- Company has a strong pipeline, with 174 ANDAs pending approval, of which 52 are Injectables.
- It has started phase III clinical trials for a COVID-19 vaccine.
- Company also shared that Unit 1 was inspected by the US FDA and it has received a form 483 with 7 observations, none of which are repeat observations or related to data integrity.

Aurobindo board canceled proposal to acquire 51% stake in Cronus for Rs 420cr

Cronus Pharma was founded in the year 2015-16. It has also one entity in India Cronus LLC. Earlier, Aurobindo announced acquisition of 51% stake in Cronus Pharma, focused on veterinary pharma products for Rs 420cr. Cronus has a pipeline of 67 products (61 organically developed) out of which 40 are injectables and 27 are non-injectable. By April-2023, the management expects the entire product line to be operationalized. Cronus generated sales of US$ 13mn from six outsourced products and management expected to grow to ~US$ 20mn. It has a 10 acre unit situated in Hyderabad SEZ. They are into multiple business segments - orals and injectables.

However post the reaction of investors' to the apparently expensive acquisition (31x EV/EBITDA), the board cancelled the proposal at its meet on Aug 20, 2021.

US generics price erosion

Most of the Indian pharmaceutical majors struggled to grow their revenue and margin in North America business in Q1FY22. An unprecedented double-digit price erosion in generics hit them. Companies like Zydus Cadila, Torrent Pharmaceuticals, Alembic Pharma, Aurobindo and Strides posted decline in US revenue. Players like Dr. Reddy' Laboratories (DRL), Lupin and Cipla saw low single-digit growth. Sun Pharmaceutical Industries, however, posted a gain in the US market, on the back of its specialty drugs. Managements commented that the generics business is facing stiff competition in some of the therapeutic area/drugs. Many new players have entered the market in the past three to five years and therefore competition continues to intensify further. Companies are therefore betting on new launches, especially in the specialty segment where there is limited competition.

Earlier Estimates

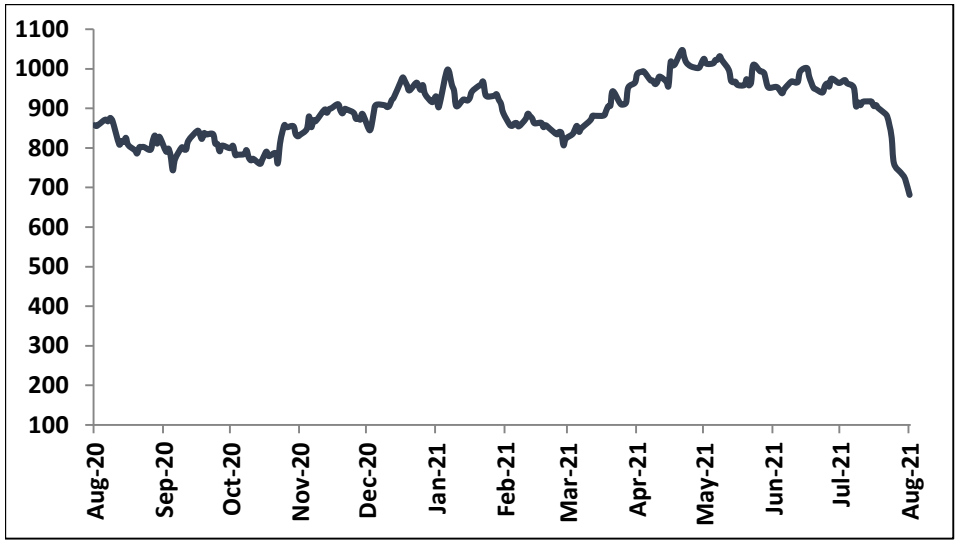
(Rs cr)	FY20	FY21E	FY22E	FY23E
Total sales	23099	25111	25998	27863
EBITDA	4864	5460	5632	6175
EBITDA margin	21.1	21.7	21.7	22.2
APAT	2849	3342	3456	3805
EPS	48.6	57	59	64.9
P/E	14.1	12.0	11.6	10.5
EV/EBITDA	8.6	7.2	6.6	5.7
RoCE (%)	14.3	13.9	12.9	13.1

Revised Estimates

(Rs cr)	FY20	FY21	FY22E	FY23E
Total sales	23099	24775	25096	27502
EBITDA	4864	5333	5307	5813
EBITDA margin	21.1	21.5	21.1	21.1
APAT	2849	3292	3181	3458
EPS	48.6	56.2	54.3	59
P/E	14.1	12.2	12.6	11.5
EV/EBITDA	8.6	7.5	7.2	6.2
RoCE (%)	14.3	10.5	11.7	11.8

Aurobindo Pharma Ltd.

Stock Price Chart



Disclosure:

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