

Aurobindo Pharma

BSE SENSEX	S&P CNX
26,668	8,160
Bloomberg	ARBP IN
Equity Shares (m)	585.2
M.Cap.(INRb)/(USDb)	459.7 / 6.8
52-Week Range (INR)	892 / 582
1, 6, 12 Rel. Per (%)	-1/-7/18
Avg Val, INRm/ Vol m	1669
Free float (%)	46.2

CMP: INR786 TP: INR1,100(+40%) Buy

Results in line with estimates; US business' growth momentum to continue

- Aurobindo Pharma (ARBP) reported net sales of INR 37.5b in 4QFY16, led by strong US sales (up 24% YoY). EBITDA stood at INR8.8b, up 35% YoY (~4% higher than our estimate), while PAT came in at INR5.6b, up 39% YoY (in line with our estimate). We believe that the fast pace of approvals in the US and improving profitability of the EU business is likely to drive the company's overall margins and earnings growth.
- **Top line growth improves in 4QFY16:** US sales grew by 24%YoY to INR16.6b, driven by new product launches and greater traction witnessed in the Natrol OTC brand. We continue to believe that the US business is likely to grow at a robust pace in the coming quarters as well, on the back of a ramp-up in the company's existing launches (Integrilin, Isosulfan, etc.), and new launches like Meropenem, Valgancyclovir, Angiomax, Nexium, etc. Europe and RoW sales grew in the double-digits at 11% YoY to INR10.1b. ARV formulation sales stood at INR3.3b, up 23% YoY. Overall top line grew by 18.5% YoY in 4QFY16 (much higher than the level recorded in the last three quarters). Going forward, we expect a top line CAGR of 16-17% over FY16-18E, led by the US business' strong product pipeline (162 pending ANDAs).
- **Robust EBITDA margin despite higher R&D expenses:** EBITDA margin at 23.5% (up >280bp YoY) was largely in line with our est. despite higher R&D expenses (4.2% of sales) for the quarter. We expect EBITDA margin to increase to 25.3% in FY18E from 22.4% in FY16, on the back of a) Strong launch pipeline in the US, and (b) Cost efficiency in EU (high single-digit margin expected by FY18).
- **Strong earnings growth trajectory and improving cash flow to drive valuations:** At its CMP, ARBP trades at 18.3x FY17E and 14.5x FY18E, which is at a ~20% discount to its peers. Going forward, the valuation gap is expected to narrow down on account of the company's increasing profitability, strong earnings growth trajectory (28% CAGR) and improving free cash flow. ARBP remains one of our top picks in the sector with a target price of INR1,100, based on 20x FY18E PER.

Financials & Valuations (INR b)

Y/E Mar	2016	2017E	2018E
Net Sales	137.7	162.4	191.5
EBITDA	30.8	39.0	48.4
PAT	19.8	25.0	32.1
EPS (INR)	33.9	42.8	54.9
Gr. (%)	25.5	26.3	28.3
BV/Sh (INR)	120.6	160.9	213.3
RoE (%)	32.5	30.4	29.3
RoCE (%)	19.5	21.1	22.4
P/E (x)	23.2	18.3	14.3
P/BV (x)	6.5	4.9	3.7

Estimate change 

TP change 

Rating change 

Quarterly performance (Consolidated)

Y/E March	FY15				FY16				FY15		FY16		(INR Million)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	FY15	FY16	FY16E			
											4QE	vs Est		
Net Sales	29,111	28,812	31,662	31,621	33,204	33,335	34,955	37,468	120,432	138,111	36,184	-3.4%		
YoY Change (%)	69.7	50.5	47.9	35.7	14.1	15.7	10.4	18.5	49.6	14.6				
Total Expenditure	22,529	22,440	25,540	25,060	25,957	25,579	26,725	28,644	95,569	106,905	27,614			
EBITDA	6,582	6,372	6,122	6,561	7,247	7,756	8,230	8,824	24,863	31,206	8,570	-4.0%		
Margins (%)	22.6	22.1	19.3	20.7	21.8	23.3	23.5	23.5	20.6	22.6	23.7			
Depreciation	908	899	673	847	891	928	995	1,113	3,326	3,926	1,049			
Interest	189	210	219	226	209	241	227	251	843	927	251			
Other Income	108	273	359	67	291	117	69	206	1,581	1,532	124			
PBT before EO expense	5,593	5,537	5,590	5,556	6,438	6,704	7,077	7,666	22,275	27,885	7,393			
Extra-Ord expense	-14	420	202	-12	256	579	-129	-46	596	660	129			
PBT	5,607	5,117	5,388	5,568	6,182	6,125	7,206	7,711	21,679	27,225	7,264			
Tax	1,464	1,404	1,563	1,534	1,865	1,622	1,860	2,097	5,966	7,444	2,017			
Rate (%)	26.1	27.4	29.0	27.6	30.2	26.5	25.8	27.2	27.5	27.3	27.8			
Minority Interest	-12	-10	-20	-5	-8	-10	-3	-14	-45	-39	-28			
Reported PAT	4,154	3,722	3,844	4,038	4,324	4,513	5,350	5,629	15,758	19,820	5,274	1.4%		
Adj PAT	4,132	4,017	3,968	4,025	4,496	4,929	5,251	5,582	16,194	20,304	5,340	-1.7%		
YoY Change (%)	362.8	37.5	-4.3	-15.2	8.8	22.7	32.3	38.7	8.9	25.4				
Margins (%)	14.2	13.9	12.5	12.7	13.5	14.8	15.0	14.9	13.4	14.7	14.8			

E: MOSL Estimates

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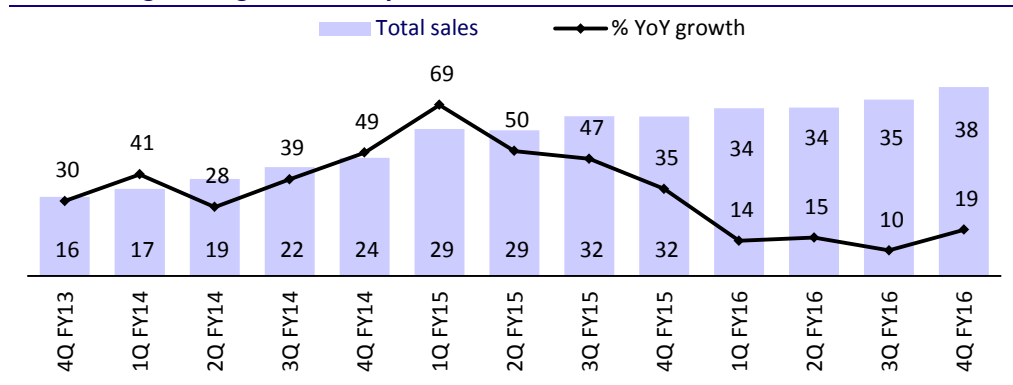
Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Business highlights

In 4QFY16, overall sales grew 10%YoY to INR38b, led by sustained growth in US business. US business grew 24%YoY to INR16.6b driven by new product launches and growing traction in Natrol. EU and RoW business grew 11.7%YoY to INR10.2b in 4Q. ARV formulation and API segment grew 23% and 14.5% respectively.

Exhibit 1: High sales growth, led by US

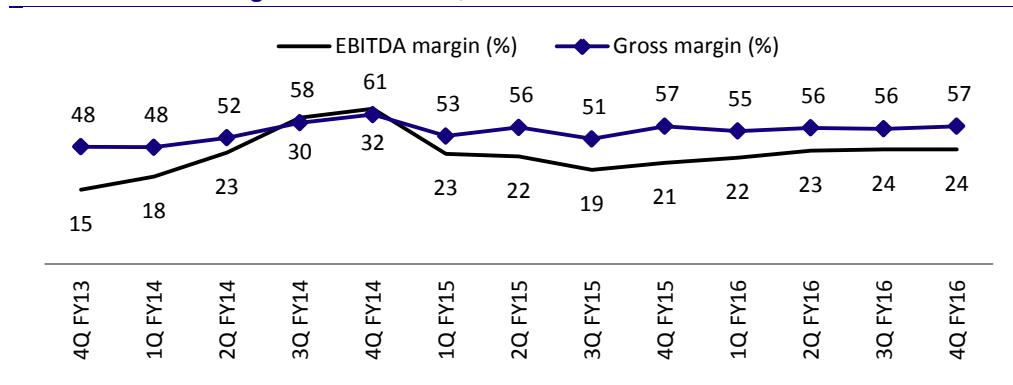


Source: Company, MOSL

EBITDA margins at historical high

EBITDA increased 36% YoY to INR8.8b (v/s estimate of INR 8.6b, in line). EBITDA margin miss of 13bps (23.5% vs 23.7% est.) was mainly driven by higher R&D expenses. Gross margins were flat YoY at 55.6% in 4Q.

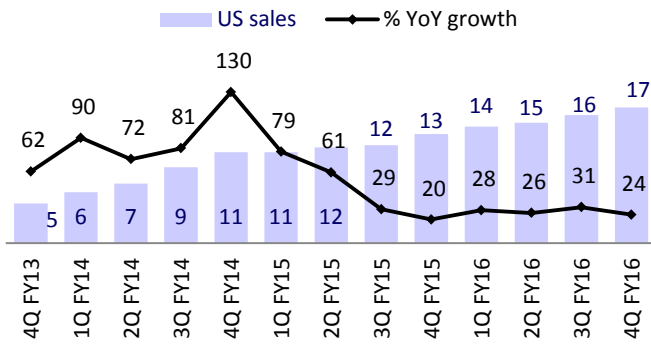
Exhibit 2: EBITDA margins at 23.5% in 4Q



Source: Company, MOSL

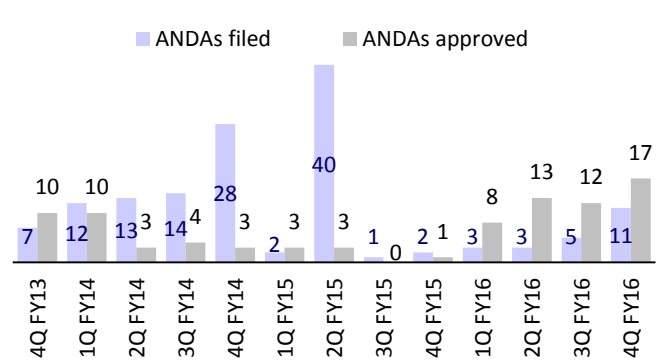
US (44% of sales): US business grew 24%YoY to INR16.6b in 4QFY16, led by new product launches during the quarter. Till date, ARBP has filed 398 ANDAs in US market and has received approvals for 251 products (includes 36 tentative ANDAs). At 162, ABRP has one of the largest ANDA pipeline for US market among Indian companies. Going ahead, ARBP is expected to launch 20-25 products every year in US market, sustaining the current growth momentum over next two years.

Exhibit 3: US sales continue to grow over a high base



Source: Company, MOSL

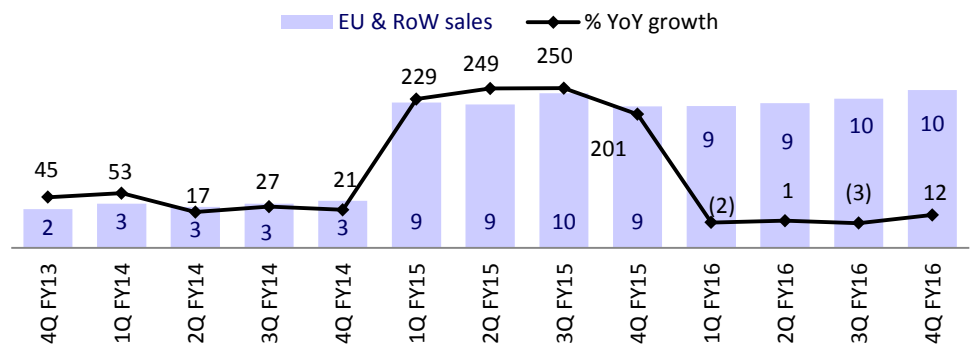
Exhibit 4: ANDA filed v/s approved (quarterly trend)



Source: Company, MOSL

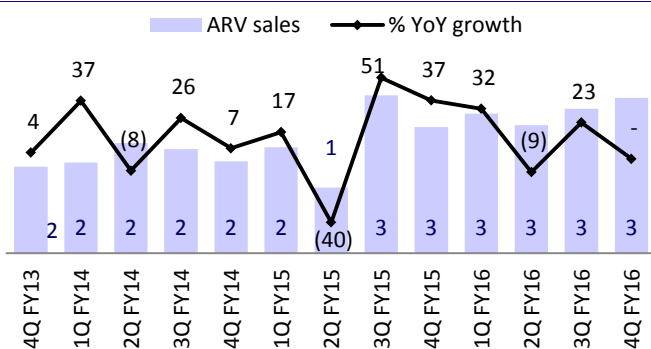
Europe & RoW (27% of sales): In 4Q, Europe and RoW business improved 11.7%YoY to INR10.2b. Europe grew 9%YoY to INR8.4b while RoW sales grew 25%YoY to INR1.8b in 4Q. This is 3rd consecutive quarter with positive EBITDA for Europe business. ARBP has guided for higher single digit margin for Europe business by FY18. Overall, we believe EU & RoW segment to grow at 4% CAGR over FY15-18E.

Exhibit 5: EU & RoW sales includes Actavis sales from 1QFY15



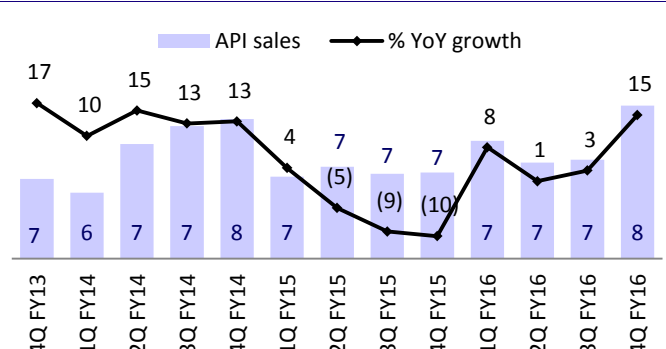
Source: Company, MOSL

Exhibit 6: ARV formulations sales trend ...



Source: Company, MOSL

Exhibit 7: API business trend ...



Source: Company, MOSL

Operating metrics

Exhibit 8: Key operating metrics

	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16
Revenue Mix (%)												
Formulations	63.0	63.1	65.9	68.1	77.2	76.6	79.0	78.8	78.5	79.5	80.3	79.5
ARV form.	11.0	12.0	10.1	8.2	7.6	4.8	10.4	8.4	8.8	8.0	8.6	8.7
US generic form.	35.8	37.5	42.7	47.1	37.9	40.2	37.5	42.0	42.5	43.8	44.5	44.0
EU form.	16.2	13.6	13.0	12.8	31.7	31.6	31.0	28.5	27.2	27.7	27.2	26.8
APIs	37.0	36.9	34.1	31.9	22.8	23.4	21.0	21.2	21.5	20.5	19.7	20.5
SSPs	12.7	12.5	11.8	10.7	8.1	7.4	6.4	6.4	6.4	5.9	5.7	5.5
Cephs	12.4	10.6	10.0	9.9	7.2	8.0	7.7	7.4	7.8	6.8	7.1	7.8
ARV and others	11.9	13.8	12.3	11.2	7.5	8.0	6.9	7.4	7.3	7.8	7.0	7.2
Revenue Gr. (%)												
Formulations	40.7	27.6	38.7	49.4	68.6	50.1	46.9	34.9	14.1	15.4	10.2	18.5
ARV form.	36.8	(7.6)	25.9	6.6	16.9	(40.4)	51.5	37.0	31.7	95.0	6.8	-
US generic form.	90.3	72.0	81.4	129.6	78.6	60.7	29.0	20.1	28.1	25.8	30.8	24.3
EU form.	52.6	17.1	27.4	21.4	229.4	249.2	249.6	200.7	(2.4)	1.0	(3.4)	11.7
APIs	10.2	15.4	12.8	13.2	3.6	(4.6)	(9.4)	(10.4)	7.9	0.9	3.1	14.5
SSPs	24.1	31.6	21.3	35.0	7.3	(11.4)	(20.4)	(19.5)	(9.2)	(7.9)	-	0.9
Cephs	(3.0)	(8.3)	(11.3)	(3.5)	(2.0)	13.6	13.7	0.4	23.3	(2.3)	1.0	25.2
ARV and others	12.6	26.6	33.0	13.1	5.5	(12.4)	(17.5)	(11.2)	11.5	12.2	10.9	15.7
As % of sales												
Raw material	52.0	48.2	42.0	38.6	47.5	43.9	48.6	43.4	45.4	44.1	44.4	43.4
SG&A	11.0	10.3	10.0	10.1	10.6	11.7	11.6	11.8	11.0	11.3	11.5	10.9
R&D cost	19.1	18.9	18.0	19.6	19.4	22.3	20.4	24.0	21.8	21.4	20.5	22.1
Tax Rate	58.3	14.6	24.3	24.8	26.1	27.4	29.0	27.6	30.2	26.5	25.8	27.2
Margins (%)												
Gross Margins	48.0	51.8	58.0	61.4	52.5	56.1	51.4	56.6	54.6	55.9	55.6	56.6
EBITDA Margins	17.9	22.9	30.1	31.9	22.6	22.1	19.3	20.7	21.8	23.3	23.5	23.5
PAT margins	10.1	6.8	5.1	15.2	19.3	20.4	14.2	13.9	12.5	14.8	15.0	14.9

Source: Company; MOSL

Valuation and view

ARBP has outperformed most Pharma peers over the last 12 months. This has been driven by significant improvement in operating performance post clearance of USFDA import alert and ramp-up in US launches, including high margin gCymbalta. With recent acquisition in EU (Actavis assets) and US (Natrol), the share of high margin formulations in total revenues has increased to ~80% (vs 54% in FY10), positioning it among large cap formulation players. Our target price of INR 1100 discounts ARBP's FY18E EPS at 20x PE multiple which is:

- At a premium to its 3 yr average P/E multiple which is justified given stronger business profile and earnings outlook
- At 10% discount to sector average target P/E multiple, factoring higher leverage and potential execution related risks.
- Implies a PEG of 0.66x (FY15-18E EPS CAGR of 26%)

We believe that the re-rating of the stock from single digit P/E multiple to current levels partly factors transition to formulations player, improved execution in US and moderation in leverage (from 1.2x D/E in FY10 to 0.7x in FY15E). However, current valuations at 18.3x FY17E and 14.3x FY18E are still at ~30-35% discount to the sector average, which is unjustified in our view. We argue for P/E re-rating for ARBP due to:

- Strong EPS outlook of 26% CAGR backed by 17% revenue growth
- Strong free cash flow generation of INR28b over FY15-18E.
- Deleveraging of balance sheet, as we expect D/E to improve to 0.2x by FY18E (vs 0.7x now).

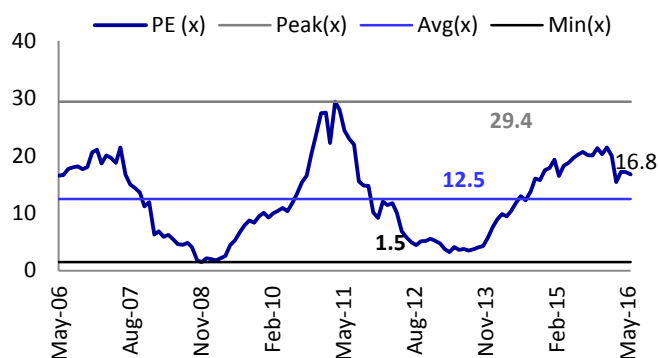
Key catalysts to drive stock's performance over the medium term are:

- Improvement in EU profitability (30% of business) led by deeper penetration in existing markets and site transfer to India.
- Launch of high margin products in US including injectables (25+ launches over next 18 months), controlled substance, etc.
- Focus on high margin triple combination ARV products in Africa (from FY16E)

Risks to our investment assumptions:

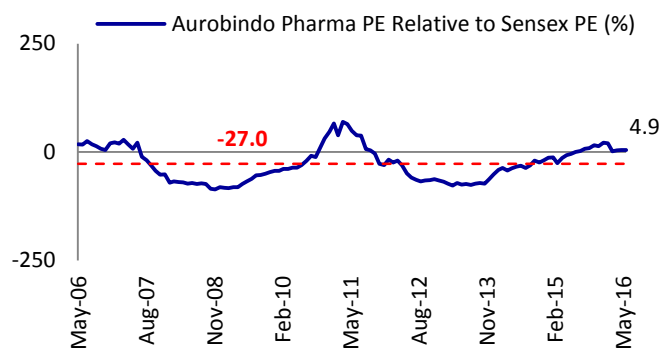
- Delay in ANDA approvals
- Worsening of pricing environment in EU.
- Currency fluctuations both in USD and EUR terms.

Exhibit 9: PE Band (x)



Source: Company, MOSL

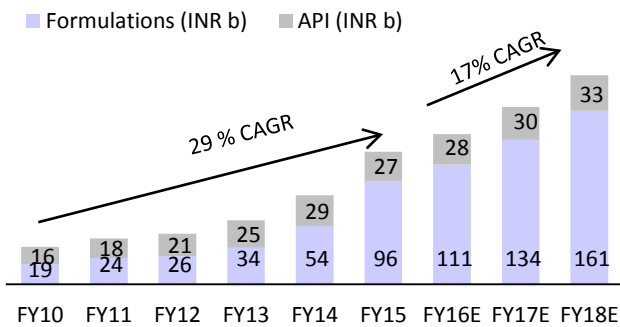
Exhibit 10: PE relative to Sensex



Source: Company, MOSL

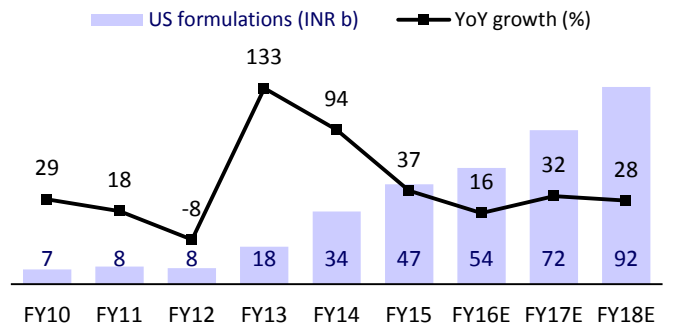
Story in charts

Exhibit 11: Formulation led sales growth (INR b)



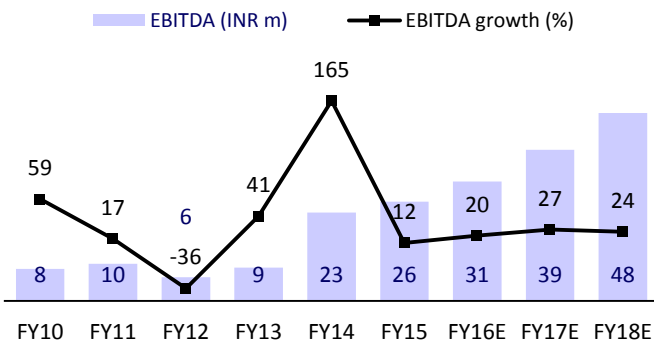
Source: Company, MOSL

Exhibit 12: US Sales to grow at 30% CAGR over FY15-18E



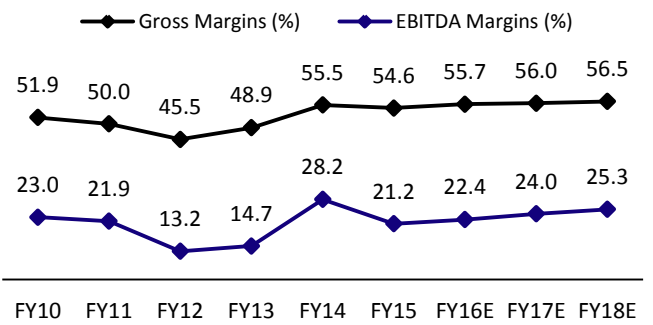
Source: Company, MOSL

Exhibit 13: EBITDA growth to improve in FY16-18E



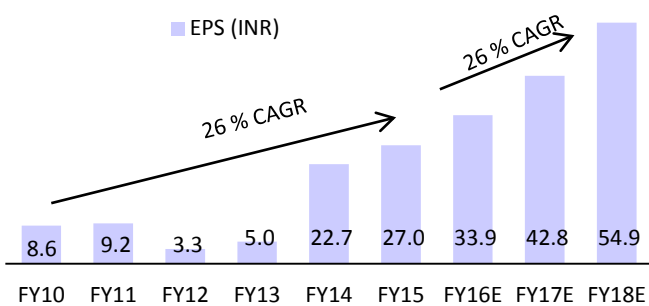
Source: Company, MOSL

Exhibit 14: EBITDA margins improving with product mix



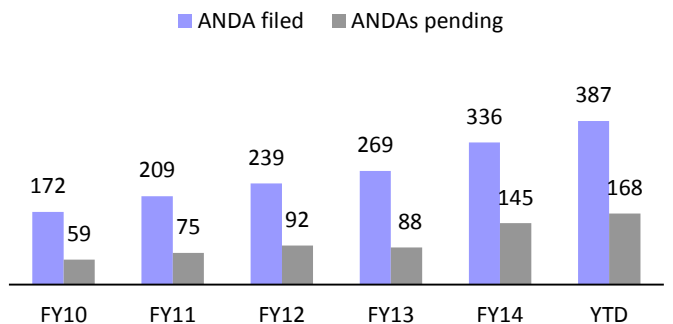
Source: Company, MOSL

Exhibit 15: EPS growth to sustain at 26%



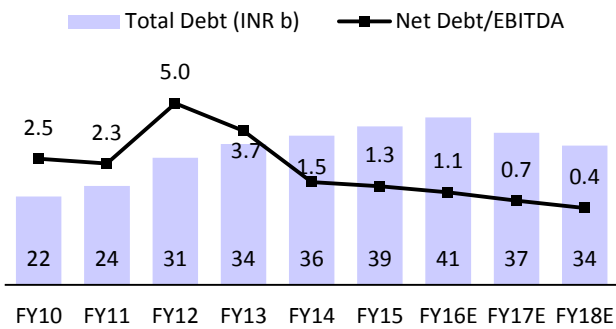
Source: Company, MOSL

Exhibit 16: Rich ANDA pipeline



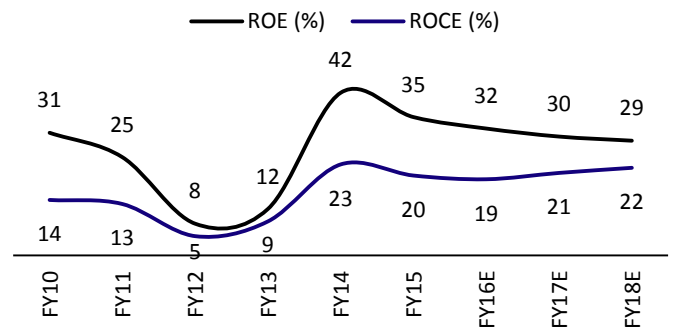
Source: Company, MOSL

Exhibit 17: Improving cash flows to reduce the debt



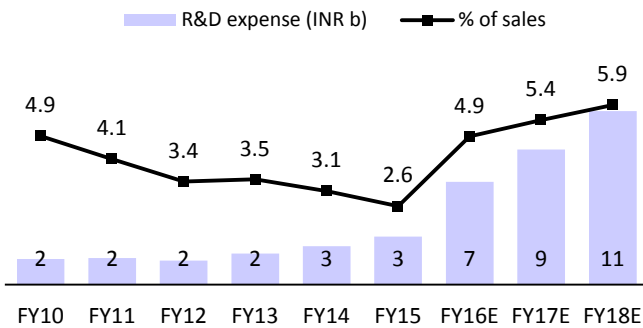
Source: Company, MOSL

Exhibit 18: Return ratios (%)



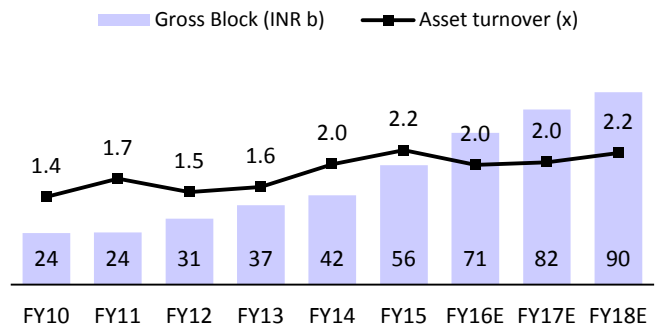
Source: Company, MOSL

Exhibit 19: R&D expense to increase going ahead



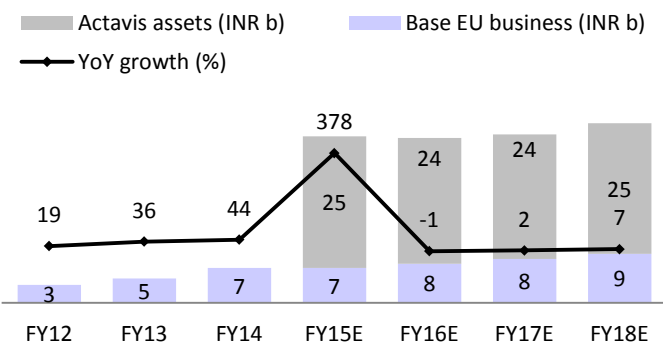
Source: Company, MOSL

Exhibit 20: Asset turnover improving ...



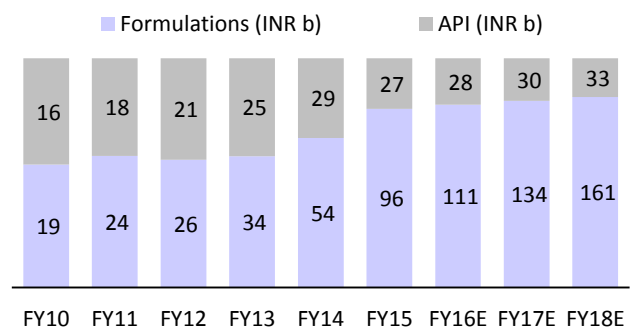
Source: Company, MOSL

Exhibit 21: EU business to grow at ~1%



Source: Company, MOSL

Exhibit 22: Formulation share getting bigger



Source: Company, MOSL

Financials and Valuations

Income Statement							(INR Million)	
Y/E Mar	2011	2012	2013	2014	2015	2016	2017E	2018E
Net Sales	43,816	46,274	58,553	80,998	121,205	137,678	162,441	191,494
Change (%)	22.5	5.6	26.5	38.3	49.6	13.6	18.0	17.9
EBITDA	9,598	6,101	8,610	22,828	25,636	30,773	38,986	48,448
EBITDA Margin (%)	21.9	13.2	14.7	28.2	21.2	22.4	24.0	25.3
Depreciation	1,715	2,005	2,487	3,125	3,326	3,926	4,735	5,152
EBIT	7,883	4,096	6,122	19,703	22,310	26,847	34,251	43,296
Interest	625	1,028	1,313	1,079	843	927	815	555
Other Income	252	247	285	232	808	682	800	1,200
Extraordinary items	372	-5,445	-1,353	-2,031	-596	-660	0	0
PBT	7,881	-2,129	3,741	16,825	21,679	25,942	34,235	43,940
Tax	2,251	-888	827	3,635	5,966	7,444	9,244	11,864
Tax Rate (%)	28.6	41.7	22.1	21.6	27.5	28.7	27.0	27.0
Min. Int. & Assoc. Share	-4	-6	-25	-38	-45	-39	-50	-55
Reported PAT	5,634	-1,235	2,939	13,228	15,758	18,537	25,042	32,131
Adjusted PAT	5,369	1,939	2,939	13,228	15,758	19,820	25,042	32,131
Change (%)	11.5	-63.9	51.6	350.1	19.1	25.8	26.3	28.3

Balance Sheet							(INR Million)	
Y/E Mar	2011	2012	2013	2014	2015	2016	2017E	2018E
Share Capital	582	582	582	583	584	585	585	585
Reserves	23,866	22,814	25,475	36,919	50,975	69,982	93,561	124,229
Net Worth	24,448	23,397	26,058	37,502	51,559	70,567	94,146	124,815
Debt	24,143	30,959	34,355	36,339	38,636	40,762	37,030	33,907
Deferred Tax	1,191	-16	680	2,054	2,058	2,365	2,412	2,460
Total Capital Employed	49,873	54,442	61,202	76,151	92,511	114,290	134,195	161,801
Gross Fixed Assets	24,380	30,863	37,080	41,817	55,810	70,873	81,873	89,873
Less: Acc Depreciation	6,994	8,916	11,246	14,371	17,697	21,624	26,359	31,511
Net Fixed Assets	17,386	21,947	25,834	27,445	38,112	49,249	55,514	58,361
Capital WIP	6,574	6,454	2,185	2,105	2,500	2,500	2,500	2,500
Investments	385	385	223	198	198	2	200	200
Current Assets	34,334	33,536	43,982	64,386	87,647	104,356	111,499	135,500
Inventory	14,553	15,456	19,236	23,675	36,113	40,881	43,080	50,208
Debtors	12,310	12,400	15,970	26,366	35,392	41,719	46,729	55,087
Cash & Bank	1,867	709	2,085	1,786	4,692	8,344	9,789	16,304
Loans & Adv, Others	5,604	4,972	6,692	12,559	11,451	13,412	11,900	13,900
Curr Liabs & Provsns	8,807	7,880	11,576	18,747	36,587	42,704	36,405	35,646
Curr. Liabilities	8,193	7,174	10,685	17,389	34,161	40,641	35,480	34,721
Provisions	614	706	891	1,358	2,426	2,063	925	925
Net Current Assets	25,527	25,656	32,406	45,640	51,061	61,652	75,094	99,853
Total Assets	49,872	54,442	61,202	76,151	92,511	114,289	134,195	161,801

Financials and Valuations

Ratios

Y/E Mar	2011	2012	2013	2014	2015	2016	2017E	2018E
Basic (INR)								
EPS	9.2	3.3	5.0	22.7	27.0	33.9	42.8	54.9
Cash EPS	12.2	6.8	9.3	28.1	32.7	40.6	50.9	63.7
Book Value	42.0	40.2	44.7	64.3	88.3	120.6	160.9	213.3
DPS	1.2	0.5	0.8	1.5	2.3	2.0	2.5	2.5
Payout (incl. Div. Tax.)	12.1	-23.6	14.9	6.6	8.3	6.3	5.8	4.6
Valuation(x)								
P/E				34.6	29.1	23.2	18.3	14.3
Price / Book Value				12.2	8.9	6.5	4.9	3.7
EV/Sales				6.1	4.1	3.6	3.0	2.5
EV/EBITDA				21.6	19.2	16.0	12.5	9.8
Dividend Yield (%)				0.2	0.3	0.3	0.3	0.3
Profitability Ratios (%)								
RoE	25.1	8.1	11.9	41.6	35.4	32.5	30.4	29.3
RoCE	13.1	4.9	8.7	23.3	20.4	19.5	21.1	22.4
RoIC	14.9	5.4	9.2	24.0	20.6	20.3	22.2	23.9
Turnover Ratios (%)								
Asset Turnover (x)	0.9	0.8	1.0	1.1	1.3	1.2	1.2	1.2
Debtors (No. of Days)	100	96	97	116	105	109	103	103
Inventory (No. of Days)	121	122	120	107	109	108	97	96
Creditors (No. of Days)	129	96	118	137	136	150	151	137
Leverage Ratios (%)								
Net Debt/Equity (x)	0.9	1.3	1.2	0.9	0.7	0.5	0.3	0.1

Cash Flow Statement

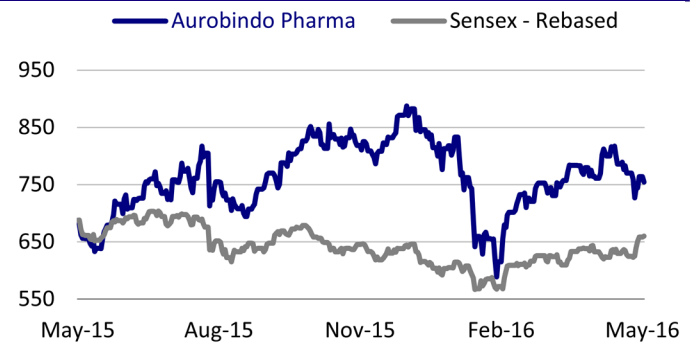
Y/E Mar	2011	2012	2013	2014	2015	2016	2017E	2018E
(INR Million)								
Adjusted EBITDA	9,598	6,101	8,610	22,828	25,636	30,773	38,986	48,448
Non cash opr. exp (inc)	252	247	285	232	808	682	800	1,200
(Inc)/Dec in Wkg. Cap.	-6,409	-1,288	-5,374	-13,533	-2,515	-6,939	-11,997	-18,244
Tax Paid	-2,251	-327	-132	-3,635	-5,966	-7,444	-9,244	-11,864
Other operating activities	372	-5,445	-1,353	-2,031	-596	-660	0	0
CF from Op. Activity	1,562	-712	2,036	3,863	17,367	16,413	18,545	19,540
(Inc)/Dec in FA & CWIP	-2,866	-6,446	-2,106	-4,656	-14,388	-15,063	-11,000	-8,000
Free cash flows	-1,304	-7,157	-70	-794	2,979	1,350	7,545	11,540
(Pur)/Sale of Invt	383	0	-163	-25	0	-196	198	0
Others	0	0	0	0	0	0	0	0
CF from Inv. Activity	-2,483	-6,446	-2,269	-4,681	-14,388	-15,259	-10,802	-8,000
Inc/(Dec) in Net Worth	1,207	474	159	-910	-386	1,641	0	0
Inc / (Dec) in Debt	2,645	6,828	3,403	2,131	2,298	2,464	-3,721	-3,110
Interest Paid	-625	-1,028	-1,313	-1,079	-843	-927	-815	-555
Divd Paid (incl Tax) & Others	-1,167	-276	-641	379	-1,142	-829	-1,366	-1,360
CF from Fin. Activity	2,060	5,998	1,608	520	-73	2,349	-5,902	-5,025
Inc/(Dec) in Cash	1,139	-1,159	1,376	-298	2,906	3,503	1,842	6,515
Add: Opening Balance	728	1,867	709	2,085	1,786	4,692	8,344	9,789
Closing Balance	1,867	708	2,084	1,786	4,691	8,195	10,186	16,304

Corporate profile

Company description

A well integrated pharma company, Aurobindo Pharma (ARBP) features among the top 10 companies in India in terms of consolidated revenues. ARBP exports to over 125 countries across the globe with more than 70% of its revenues derived out of international operations. With multiple facilities approved by leading regulatory agencies such as USFDA, EU GMP, UK MHRA, South Africa-MCC, Health Canada and Brazil ANVISA, ARBP makes use of in-house R&D for rapid filing of patents, Drug Master Files (DMFs), Abbreviated New Drug Applications (ANDAs) and formulation dossiers across the world. ARBP is among the largest filers of DMFs and ANDAs from India.

Exhibit 1: Sensex rebased



Source: MOSL/Bloomberg

Exhibit 2: Shareholding pattern (%)

	Mar-16	Dec-15	Mar-15
Promoter	53.8	53.9	54.0
DII	7.3	6.5	6.2
FII	27.4	28.8	29.6
Others	11.5	10.9	10.2

Note: FII Includes depository receipts

Source: Capitaline

Exhibit 3: Top holders

Holder Name	% Holding
Stichting Depository APG Emerging Markets Equity P	1.6
HDFC Trustee Company Ltd HDFC Equity Fund	1.5
Jhunjhunwala Rakesh Radheshyam	1.3
NA	0.0
NA	0.0

Source: Capitaline

Exhibit 4: Top management

Name	Designation
K Ragunathan	Chairman
K Nithyananda Reddy	Vice Chairman & Whole Time Dir
N Govindarajan	Managing Director
A Mohan Rami Reddy	Company Secretary

Source: Capitaline

Exhibit 5: Directors

Name	Name
D Rajagopala Reddy	M Sitarama Murthy
P Sarath Chandra Reddy	P V Ramprasad Reddy
M Madan Mohan Reddy	M Sivakumaran
Avnit Bimal Singh	

Exhibit 6: Auditors

Name	Type
KPMG	Internal
S Chidambaram	Secretarial Audit
S R Batliboi & Associates LLP	Statutory
Sagar & Associates	Cost Auditor

Source: Capitaline

Exhibit 7: MOSL forecast v/s consensus

EPS (INR)	MOSL forecast	Consensus forecast	Variation (%)
FY17	42.8	43.3	-1.2
FY18	54.9	51.7	6.2

Source: Bloomberg

NOTES

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