

Aurobindo Pharma

Reco: Buy

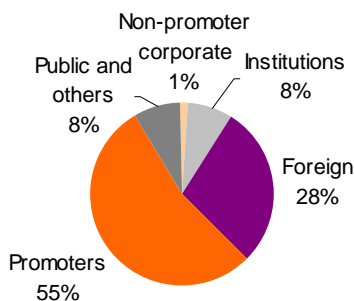
Stock Update

Expanding wings to foray into nutraceutical business; maintain Buy
CMP: Rs1,097

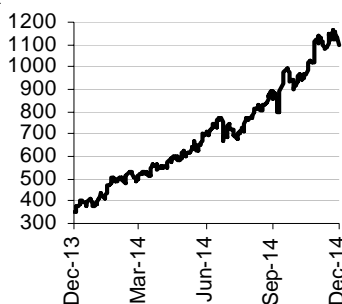
Company details

Price target:	Rs1,272
Market cap:	Rs31,943 cr
52 week high/low:	Rs1,171/310
NSE volume: (no. of shares)	15.8 lakh
BSE code:	524804
NSE code:	AUROPHARMA
Sharekhan code:	AUROPHARMA
Free float: (no. of shares)	13.4 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.9	26.5	62.2	266.2
Relative to Sensex	3.6	24.1	48.8	173.4

Key points

- Acquisition of Natrol to expand horizon:** Having strengthened its positioning in generic injectables, controlled substances and other niche prescriptions and institutional business, Aurobindo Pharma (Aurobindo) is set to expand its presence in nutraceutical and health supplement markets through the acquisition of Natrol LLC. The company emerged as the highest bidder at a consideration of \$132.5 million for Natrol, which was seeking bankruptcy in a US court. Natrol has seven key brands, an extensive distribution network in the USA, Europe and some other Asian countries, an e-commerce platform and manufacturing assets in California (USA). The acquisition will provide a readymade launchpad for Aurobindo to play in the fast growing nutraceutical and health supplement markets (market size estimated to be \$30 billion in USA). Natrol is currently a profitable company (thus earning accretive for the company from day one) and has immense potential to grow.
- QIP to back up balance sheet:** The company has taken requisite approvals to raise funds upto \$350 million through issue of securities (mainly through Qualified Institutional Placements [QIPs]). The funds raised would be invested in strengthening the manufacturing capabilities and other growth opportunities. Currently, the company has approximately \$447 million (till the end of Q2FY2015) of debts and has planned a capital expenditure of Rs1,150 crore in the next two years. The equity expansions would comfort the balance sheet, while the operating leverage will continue to be stronger.
- We continue to recommend Buy on the stock with a price target of Rs1,272 and potential upside from Natrol:** We consider the acquisition of Natrol a positive development for the company. However, we prefer to wait for more clarity on the revenue potential and the margin profile of Natrol (which faced business disturbances before going bankrupt and therefore the current revenue and margin profile has a potential to see a material change in the couple of years), before adjusting the event in our revenue model. We maintain our Buy rating on the stock with a price target of Rs1,272 (implies 16x FY2017E EPS).

Valuations

Particulars	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Net sales (Rs cr)	5,855.0	8,100.0	11,703.5	13,061.7	15,571.1
PAT (Rs cr)	457.0	1,376.0	1,651.0	1,894.0	2,318.0
Shares in issue (cr)	29.1	29.2	29.2	29.2	29.2
EPS (Rs)	15.7	47.2	56.6	65.0	79.5
Y-o-Y change (%)	85.5	200.6	20.0	14.7	22.4
PER (x)	69.8	23.2	19.3	16.9	13.8
Cash EPS (Rs)	24.2	57.9	69.5	79.3	95.3
Cash PER (x)	45.2	18.9	15.8	13.8	11.5
EV/EBIDTA (x)	39.5	16.6	13.3	11.3	8.9
Book value (Rs/share)	89.5	128.7	181.9	245.7	324.0
P/BV (x)	12.2	8.5	6.0	4.5	3.4
Mcap/sales	5.4	3.9	2.7	2.4	2.1
RoCE (%)	12.2	26.9	28.6	28.5	30.4
RoNW (%)	18.5	43.3	36.5	30.4	27.9

Natrol to provide a new business horizon

Natrol has over 34 years of presence in the US market and it is a well known player in the nutrition space including vitamins, minerals and supplements; diet and weight management products, sports nutrition products, products and formulas for hair, skin and nails. Natrol's portfolio of brands includes Natrol, Medical Research Institute (MRI), Prolab, Laci Le Beau, Promensil, Trinovin, NuHair and Shen Min. Natrol products are manufactured in the USA and distributed through various health food stores, drug and grocery stores and mass-market retailers, as well as through e-commerce platform. Natrol is in the process of opening a new manufacturing facility near its Chatsworth headquarters (USA), which will further expand the manufacturing capabilities.

On an adjusted and annualised basis, Natrol is currently generating a revenue of \$100 million and operating profit of \$14 million. However, as the company's business has seen disturbances while undergoing bankruptcy, weaker proceedings and management, it has potential to see a material change in the revenue and margin profile under the new management and improved products basket.

Acquisition strategy augurs well for Aurobindo

In a span of nine months, Aurobindo has completed two strategic acquisitions to strengthen its presence in the key focus areas. The company completed the acquisition of certain commercial operations in Western Europe from Actavis in April this year. The acquisition of European operations of Actavis provides a strong foothold for the company in the European bulk drugs market. However, since Actavis was incurring loss from its commercial operations in Europe, Aurobindo got the deal at attractive prices (consideration of Euro 30 million for a business having annual sales of Euro 320 million, though loss making). The acquisition of Natrol is a strategic one and

the company has been able to strike the deal at a reasonably good price (consideration of \$132.5 million for a company having \$100 million annualised sales, strong brand equity, and an extensive distribution network and clients base).

Lucrative opportunity in nutrition business

The nutrition market is pegged at \$30 billion in USA and is witnessing a healthy growth. Aurobindo would be able to capitalise on extensive distribution network built by Natrol and its flagship brands, which are well recognised in the US market. We believe Aurobindo would be re-organising its business and start afresh with a few flagship brands in hand coupled with an introduction of new products.

Other business continues to see strong traction

The company witnessed a 60% growth in sales and a 67.5% jump in the net profit during H1FY2015 on the back of 180BPS expansion in operating margins. The growth was supported partially by the integration of the European operations of Actavis units and sales of generic Cymbalta under shared exclusivity. We expect the company's revenue and profit to grow at a compounded annual growth rate (CAGR) of 24% and 20% over FY2014-17E, respectively (without adjusting for potential revenue from Natrol).

We continue to recommend Buy on the stock with a price target of Rs1,272 and potential upside from Natrol

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