Verson 2.0 – Bigger, Better, Stronger

Size of a leader + growth of a start-up

- **In the last four years, Aurobindo Pharma's PAT has grown 10x while its market cap has grown 12x. Post this stupendous performance, the obvious question that stands before us is, "How much steam is still left?"**
- **To understand the future outlook, we spent a full day with Aurobindo Pharma (ARBP), meeting its senior management (*Mr PV Ramprasad Reddy, Executive Chairman, Aurobindo Pharma USA, and Mr Sanjeev Dani, European and EM Business Head*) and visiting the company's largest facility that supplies to the US (Unit VII).**
- **Though ARBP has reached a size where it is competing with the market leaders, Mr Reddy has a defined plan for the next four years during which he sees potential for almost all business verticals to more than double.**

Our key takeaways:

US business has potential to more than double in four years: ARBP's US business, which was a little shy of USD1b in FY16, is likely to double in four years and reach USD2b by FY20. The company currently covers 45-50% of the US generics (Gx) market and plans to cover at least 70% over the next 4-5 years. Its current ANDA pipeline of 147 includes products in niche areas like injectables, ophthalmics, specialty products and controlled substances. ARBP is working on new opportunities including depot injections, inhalers, patches and films.

- **Injectables business to grow multifold over next 4-5 years:** Mr Reddy, who oversees the US business himself, believes that the Injectables business has the potential to grow multifold from current levels of ~USD100m over the next four years. Hormones and Oncology-related filings should start from 2HFY17.
- **Nutraceuticals and OTC:** Natrol business has the potential to grow at high teens. Cost control measures are already bearing fruits (EBITDA margin for this business has come closer to the company average). Auro Health (OTC) business started contributing to sales from FY16. The company currently has 20 pending ANDAs and 30 products under development in the OTC space.
- **Oral Solids to remain largest contributor:** The Oral Solids business currently accounts for majority of US sales (~80%). More than 70% of pending fillings are still in the Oral Formulations space. Though other segments would grow at a faster pace due to lower base effect, the Oral Solids business would continue to be the key contributor on the back of over 100 pending ANDAs.

Margin lever in Europe could continue to surprise positively: Since the acquisition from Actavis, Auro has been able to turn the European portfolio from EBITDA margin loss of ~6% to EBITDA positive levels as at the end of FY16. Until now, the company has been able to transfer supply of 32 products to India and plans to add another 10 products to this list by 1HFY17 (42 products would account for ~10% of total sales). The company's Vizag facility (dedicated for Europe supply) recently received regulatory approval and product supply would commence from 2HFY17. ARBP expects European margins to reach high single digits and low teen levels in FY18/19 from almost 0% currently. This could help add USD60m-70m to its EBITDA (12-15% of current EBITDA).

Aurobindo Pharma

Mr PV Ramaprasad Reddy, Executive Chairman, Aurobindo Pharma USA Inc

Mr Penaka Venkata Ramaprasad Reddy has been an Executive Chairman at Aurobindo Pharma USA Inc since December 1, 2012. Mr Reddy served as Executive Chairman of Aurobindo Pharma Limited until June 1, 2012. He has been a Non-Executive Director of Aurobindo Pharma Limited since November 30, 2012. He serves as a Director of APL Pharma Thai Limited, APL Holdings, Inc, USA, Aurobindo (Datong) Bio-Pharma Co Ltd, Aurobindo Tongling (Datong) Pharmaceutical Co Ltd – all these are subsidiaries of Aurobindo Pharma Limited. He Joined Aurobindo Pharma in 1986 and has served as its Whole Time Director. He was hailed by World Pharmaceutical Frontiers as one of the 35 most influential people in the pharmaceutical industry in 2008. Mr Reddy is a Postgraduate in Commerce.

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Dolutegravir would be the next growth driver for ARV business: ARV business generated sales of ~USD175m and accounted for ~9% of sales in FY16. Mr Reddy sees Dolutegravir (DTG) as a key growth driver for the ARV business. The company has already filed ANDA application for DTG 50mg with USFDA under the PEPFAR program. ARBP is also working on a triple drug combination containing DTG. The market size for DTG is expected to be ~USD2b in 2017. ARBP could be the market leader in the generic DTG space on the back of its triple combination launch.

Capex to come down post FY17: Capex for FY17 would be INR11b-12b (in line with FY16). This is primarily towards funding five greenfield and four brownfield projects. Post completion of these projects, the company would have ample capacity to handle projects at least till 2020 (and any new greenfield expansion if required would happen only from 2019). The company expects annual capex to come down to INR6b-7b post FY17. Lower capex along with strong growth in the US and margin expansion in Europe will help ARBP to generate FCF of >USD500m over the next three years.

Potential to become debt-free in three years: Lower cash flow generation has been one the biggest push backs for the company. Mr Reddy expects FCF generation of USD120m-130m in FY17 and believes the company would become debt-free (without assuming any acquisition) over the next three years, driven by internal accruals (net debt of USD580m as at the end of FY16).

R&D cost bound to go up: R&D cost, which stood at 3.4% of sales in FY16, is expected to go up considerably on the back of investments in niche areas including complex injectables, opthals, inhalers and patches. Impact of increase in R&D would be more than compensated by operating leverage in US, EU and ARV business.

Remains one of our top picks in the sector: ARBP trades at ~13x FY18E EPS, at 20-30% discount to large cap peers. Going ahead, valuation gap is expected to narrow down on the back of increasing profitability and strong free cash flow generation. ARBP remains one of our top picks with a target price of INR1,100 (20x FY18E EPS).

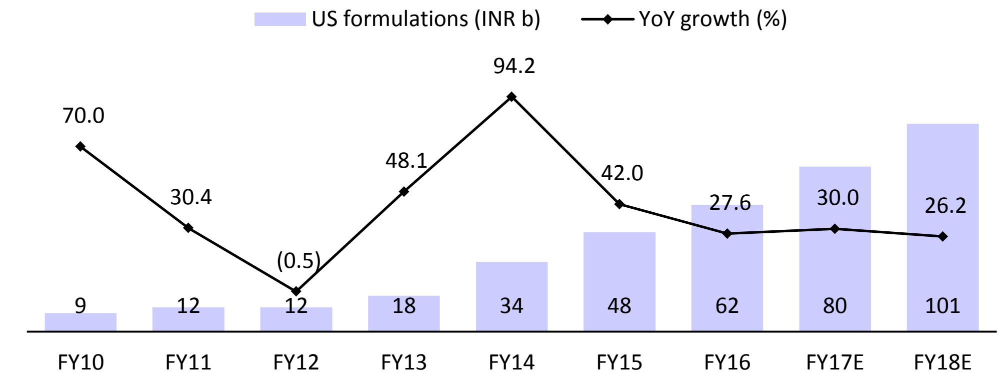
Risks: USFDA inspection is an ongoing (but critical) business risk. Over the next 2-3 months, 3-4 facilities of ARBP are scheduled for USFDA inspections (largely product approval-related inspections). In the last 2-3 years, no plant of ARBP has come under USFDA scanner. This provides some comfort around quality issues at ARBP plants.

US business – strong growth to sustain

US business to grow at a CAGR of 28%+ over FY16-18E

Over FY10-15, ARBP delivered robust 42% CAGR on the back of niche oral launches (including Cymbalta), entry into Injectables, Controlled Substances and Government Tender business. Despite a strong growth phase in the last five years, we believe ARBP is well poised to maintain this growth momentum for the next few years. We expect US business to grow at a CAGR of ~28% over FY16–18 (Injectables portfolio to grow at 35-36%). Consequently, the contribution of US sales is expected to increase from ~39% in FY15 to ~53% in FY18.

Exhibit 1: US business to grow at 28-29%YoY

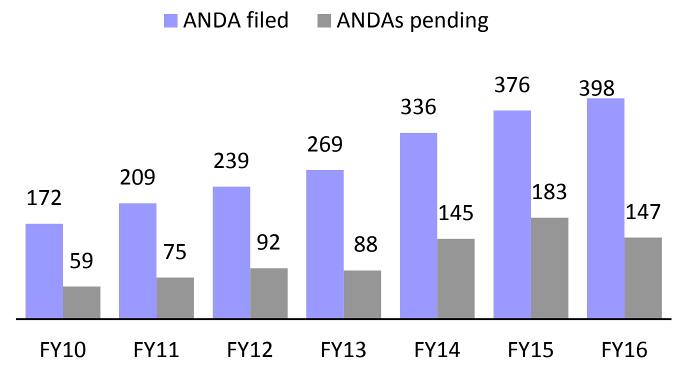


Source: Company, MOSL

Burst of approvals provide strong visibility of future growth

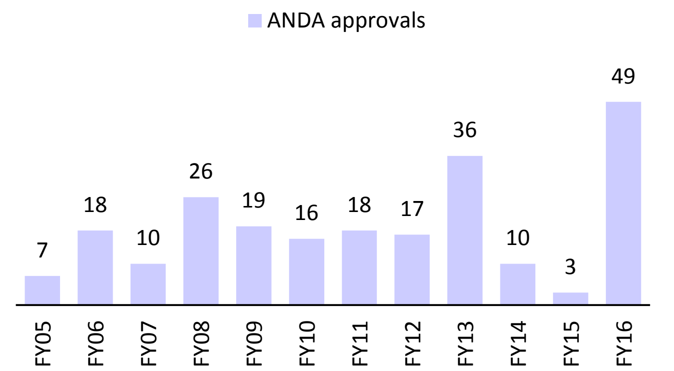
In FY16, ARBP has received 49 approvals from USFDA, which could add USD130m-150m to annual sales. The number of approvals received in FY16 is close to four times the number received in the whole of FY15 and FY14 put together (~13 approvals). The approvals are a mix of plain vanilla generics, limited competition Injectables and complex Oral generics. Given that out of the pending Injectable portfolio of >50 pending ANDAs, most were filed in FY12 and FY13; we expect multiple Injectable approvals to come through in the next two years.

Exhibit 2: Robust ANDA pipeline



Source: Company, MOSL

Exhibit 3: Highest pending ANDAs among peers

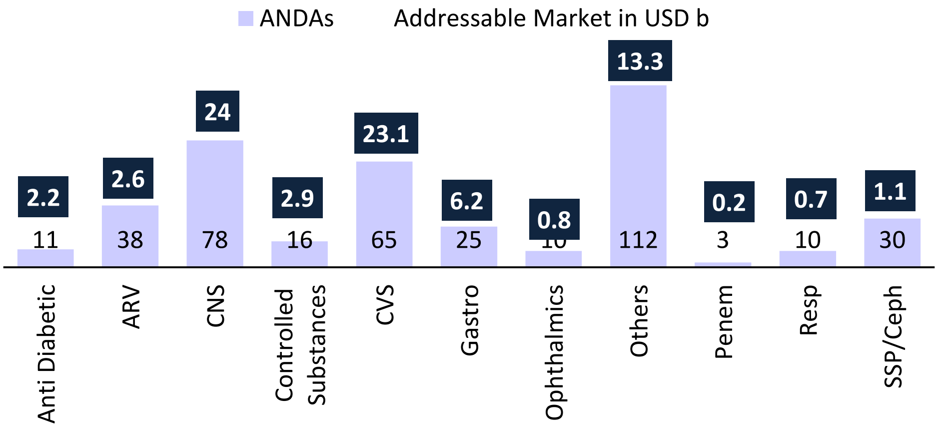


Source: Company, MOSL

Exhibit 4: Unit wise ANDA Filings as on 31-Mar-2016

Unit	Details	Final Approval		Tentative Approval		Under Review		Total	
		Mar-15	Mar-16	Mar-15	Mar-16	Mar-15	Mar-16	Mar-15	Mar-16
III	Oral Formulations	91	93	19	19	4	12	114	124
IV	Inj & Ophthalmics	8	28		2	58	37	66	67
VI B	Ceph Oral	10	11			1		11	11
VII (SEZ)	Oral Formulations	29	54	8	15	101	79	138	148
XII	Penicillin Oral & Inj	19	19					19	19
Auro Life USA	Oral Formulations	9	10			17	16	26	26
Auronext	Penem Inj					2	3	2	3
Total		**166**	**215**	**27**	**36**	**183**	**147**	**376**	**398**

Exhibit 5: Expanding Portfolio Mix Towards High-value Products



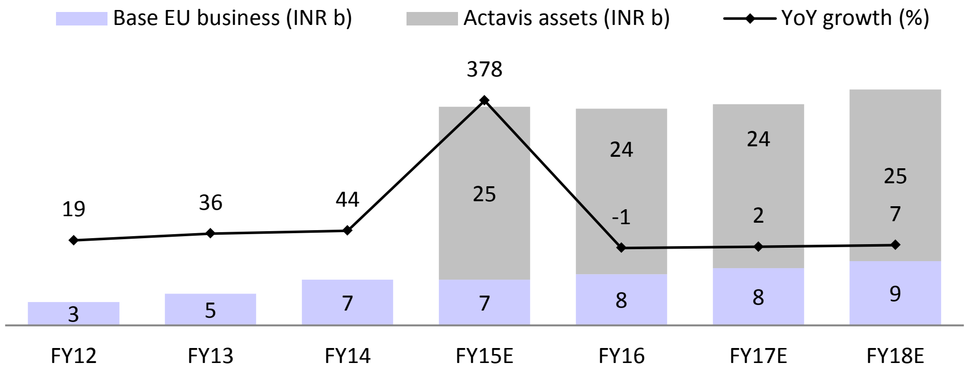
Source: Company, MOSL

European operations – Actavis acquisition to provide scale

ARBP has expanded its Europe business inorganically. Till date, it has acquired three businesses in Europe – Milopharm in 2006, Pharmacin in 2007 and Actavis in 2014. European business sales grew four fold in FY15 to INR31.9b on the back of the acquisition of Actavis' Europe business. As a result, Europe sales contribution has also increased from 8% in FY14 to 26% in FY15.

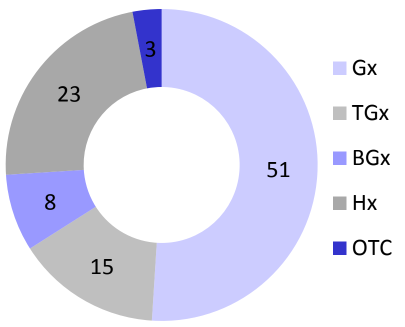
Actavis business was making substantial losses when it was acquired by ARBP in 2014. However, the shift in manufacturing location from Europe to India is likely to bring substantial cost savings. ARBP has site transferred 28 products to its Indian facility and has achieved EBITDA breakeven in the EU region.

Exhibit 6: EU growth bolstered by Actavis buy



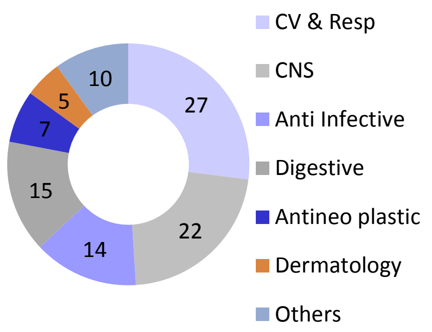
Source: Company, MOSL

Exhibit 7: Sales split by Channel



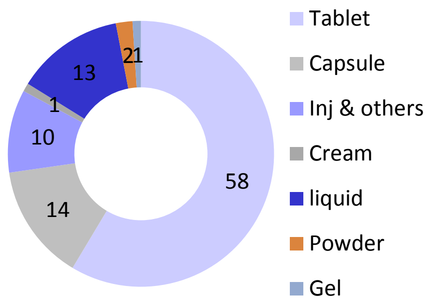
Source: Company, MOSL

Exhibit 8: Sales split by Therapeutic Profile



Source: Company, MOSL

Exhibit 9: Sales split by Dosage Forms



Source: Company, MOSL

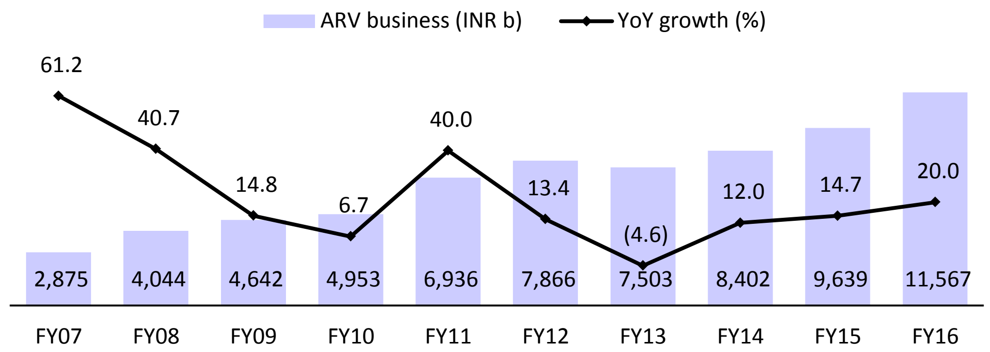
Exhibit 10: EU: Portfolio mix across channels

Channels	Gx	BGx	Hx	TGx
Geographies	All 9 countries	7 countries	All 9 countries	Germany, Spain & Netherlands
# of Products	761 (Primarily tablets & capsules)	34	343 (predominantly Inj)	765 (Including Gx products)
Other Highlights	Amongst top 10 in most markets	Includes leading brands such as Neotigason, Floxapen, Bezalip among others	Focus on high value areas including oncology	Tender based business

ARV business – Significant opportunity

ARV business grew 15% in FY15 to INR9.7b, driven by improving traction in tenders. The company provides cost effective generic version of >43 ARV products catering to more than 100 countries and 2m HIV patients. ARBP plans to focus on high value triple combination products. WHO recently included Tenofovir Triples as First Line Treatment (FLT). Currently, out of USD1b Tenfovir Triples market, ARBP's share is only 4%.

Exhibit 11: ARV business



Source: Company, MOSL

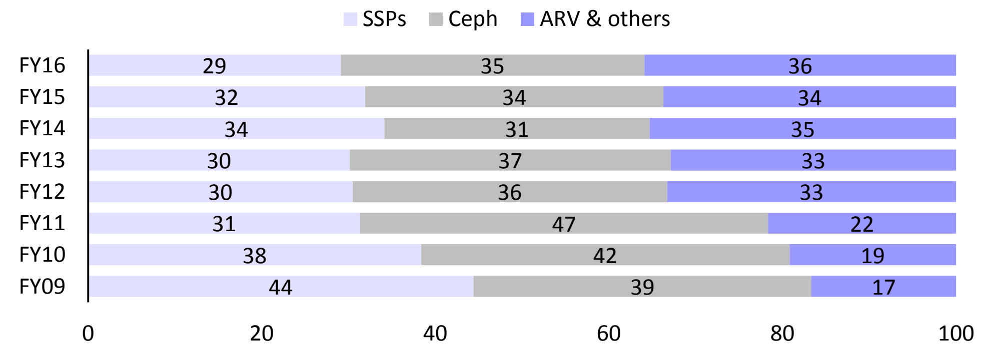
Dolutegravir (DTG) – The Next Growth Driver

- ARBP is the first generic company to sign license with ViiV Healthcare for the next generation Integrase Inhibitor – DTG
  - Filed an ANDA application for DTG 50mg with USFDA under the PEPFAR program.
  - WHO announced this drug as a 1st line reserve drug in its 2015 HIV treatment guidelines.
  - Play a collaborative role in upgrading millions of patients to the latest best in class ARV drug.
- Developing a Triple drug combination containing DTG.
- Market size is expected to be USD2b in 2017; Triple combination drug containing DTG expected to garner major share.

APIs – Ramping up capacities to meet demand

API sales declined 6% in FY15 to INR27b, impacted by shift in focus to formulations and growing captive consumption. Broadly, API business is divided into three categories – SSPs, Cephalosporin and non-Betalactum. SSP sales declined 12% to INR8.6b while Cephalosporin sales grew 6% to INR9.3b. Non-Betalactum sales declined 10% to INR9.1b, affected by weaker traction in ARV tenders in FY15. Slowdown in growth is due to increasing pricing pressures and strategy to stay out of low margin products. This focus is clearly visible from the uptick in the share of non-Betalactum products from 17% in FY09 to 34% in FY15. Going ahead, the ARV segment would be the key driver of API business that will drive profitability and revenue growth. However, we expect overall API business contribution to decline from 22% in FY15 to 16% in FY18.

Exhibit 12: API mix shifting toward high-margin products



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).

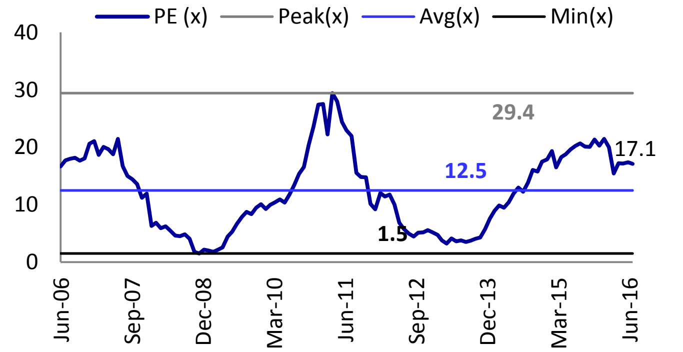
Key catalysts to drive stock's performance over the medium term are:

- 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:

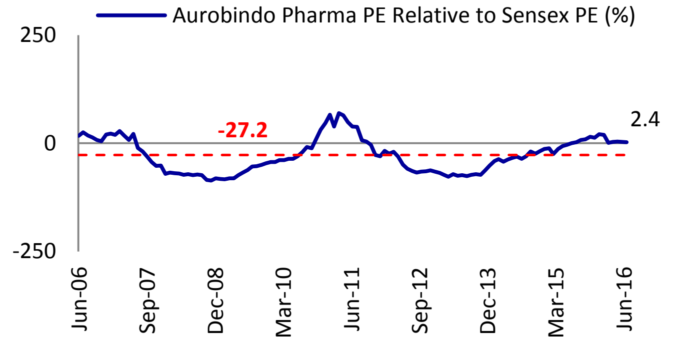
- Delay in ANDA approvals
- Worsening of pricing environment in EU.
- Currency fluctuations both in USD and EUR terms.

Exhibit 13: PE Band (x)



Source: Company, MOSL

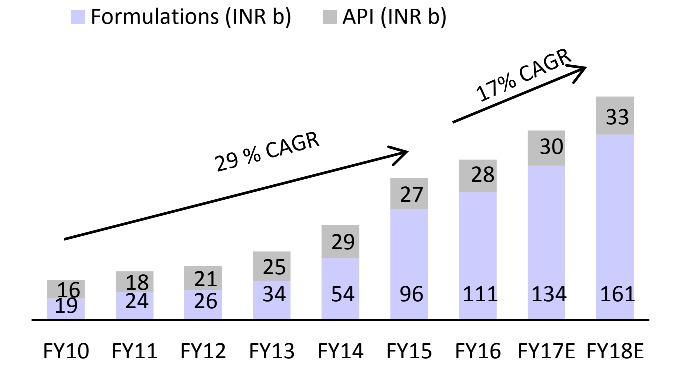
Exhibit 14: PE relative to Sensex



Source: Company, MOSL

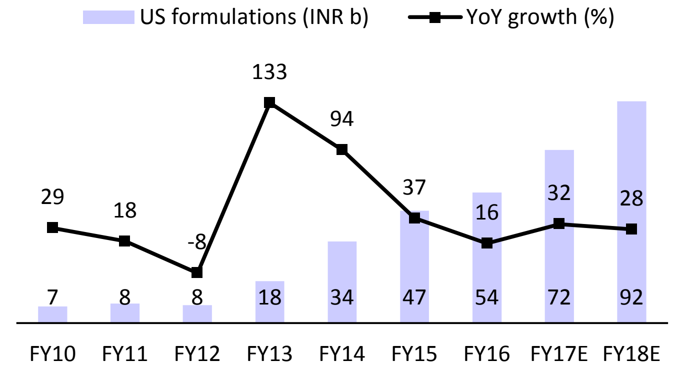
Story in charts

Exhibit 15: Formulation led sales growth (INR b)



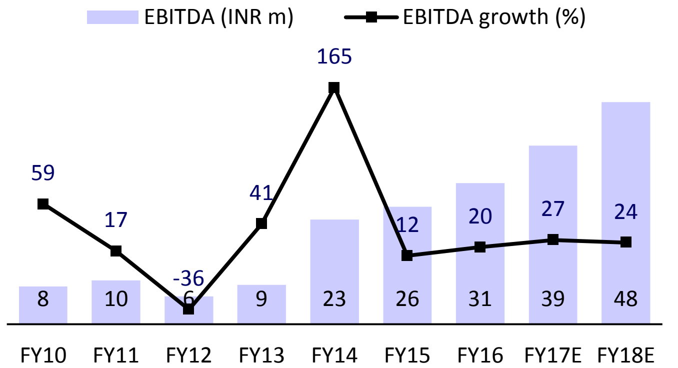
Source: Company, MOSL

Exhibit 16: US Sales to grow at 28% CAGR over FY16-18E



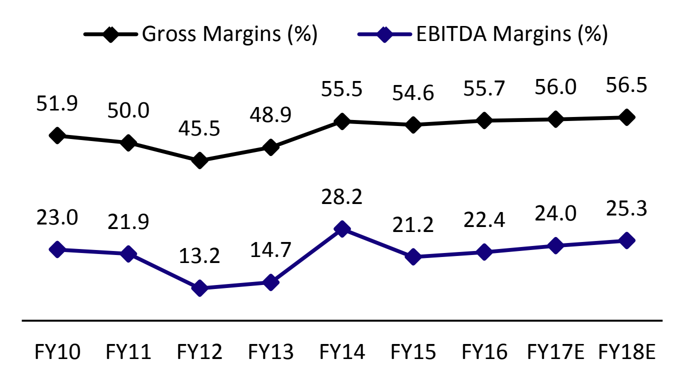
Source: Company, MOSL

Exhibit 17: EBITDA growth to improve in FY16-18E



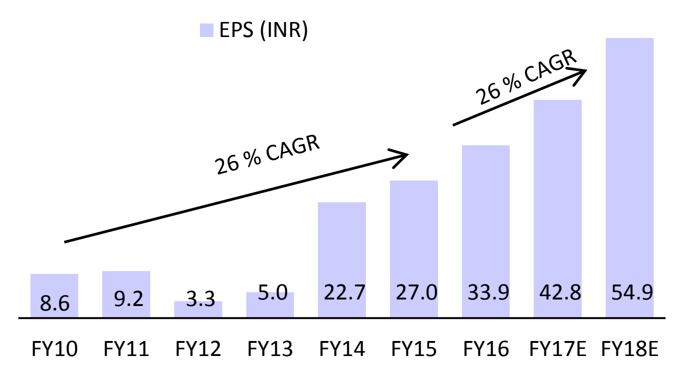
Source: Company, MOSL

Exhibit 18: EBITDA margins improving with product mix



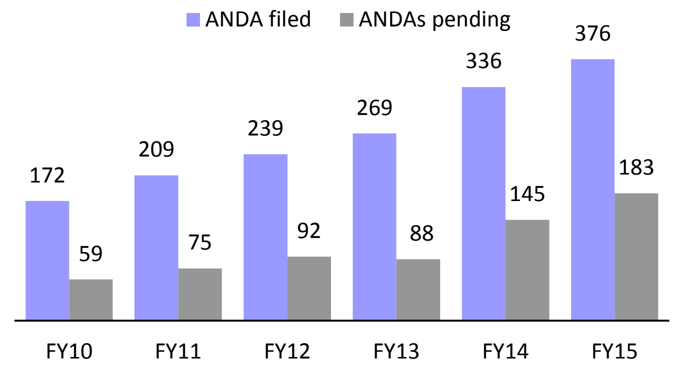
Source: Company, MOSL

Exhibit 19: EPS growth to sustain at 26%



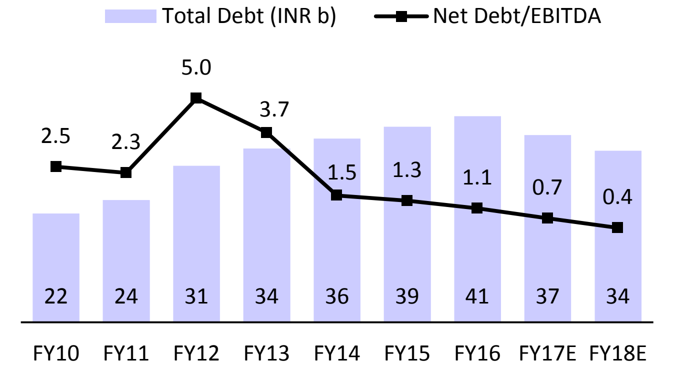
Source: Company, MOSL

Exhibit 20: Rich ANDA pipeline



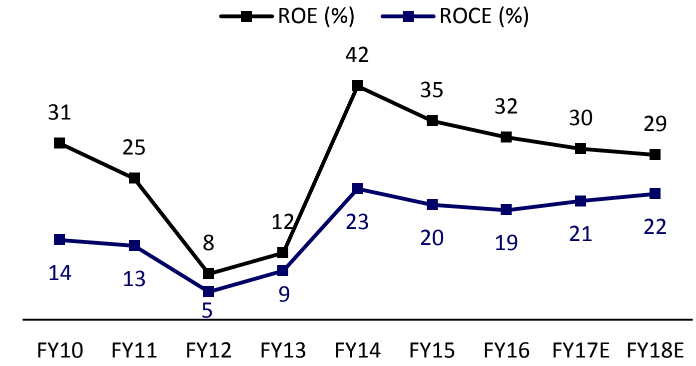
Source: Company, MOSL

Exhibit 21: Improving cash flows to reduce the debt



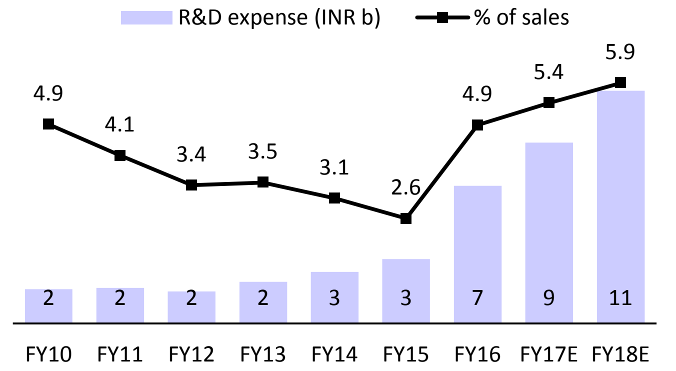
Source: Company, MOSL

Exhibit 22: Return ratios (%)



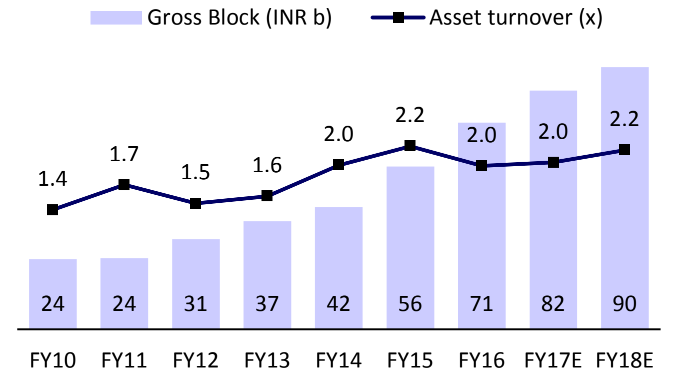
Source: Company, MOSL

Exhibit 23: R&D expense to increase going ahead



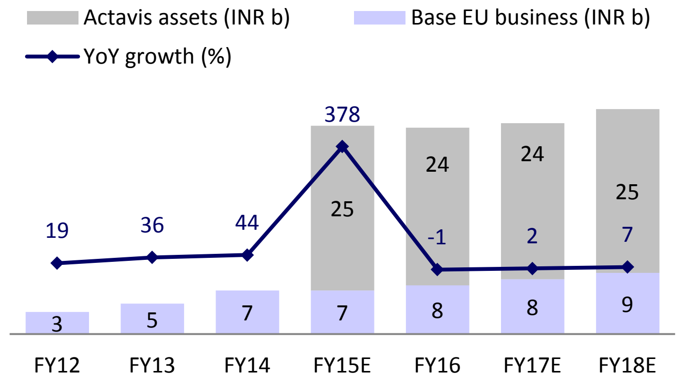
Source: Company, MOSL

Exhibit 24: Asset turnover improving …



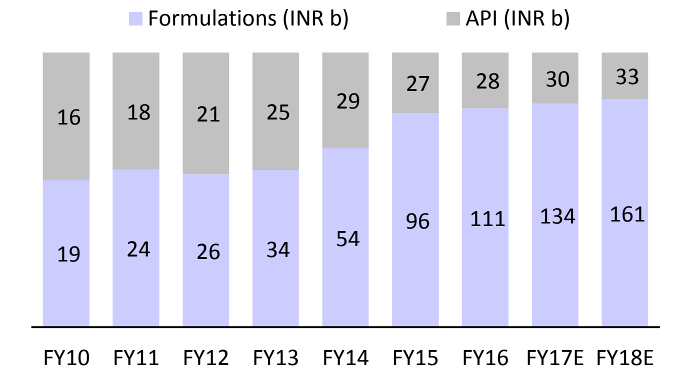
Source: Company, MOSL

Exhibit 25: EU business to grow at ~1%



Source: Company, MOSL

Exhibit 26: 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 & Provns	**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**

E: MOSL Estimates

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					26.8	21.3	16.9	13.2
Price / Book Value					8.2	6.0	4.5	3.4
EV/Sales					3.8	3.3	2.8	2.3
EV/EBITDA					17.8	14.8	11.5	9.1
Dividend Yield (%)					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

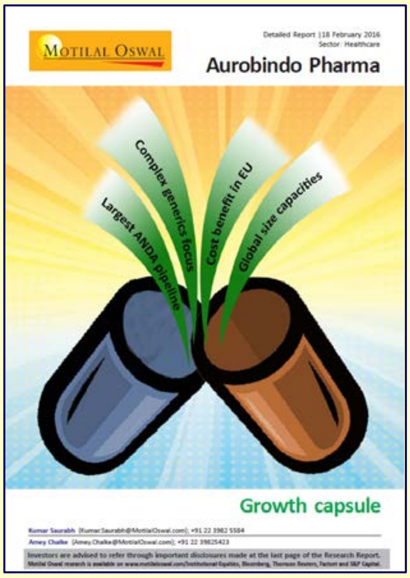
Cash Flow Statement (INR Million)

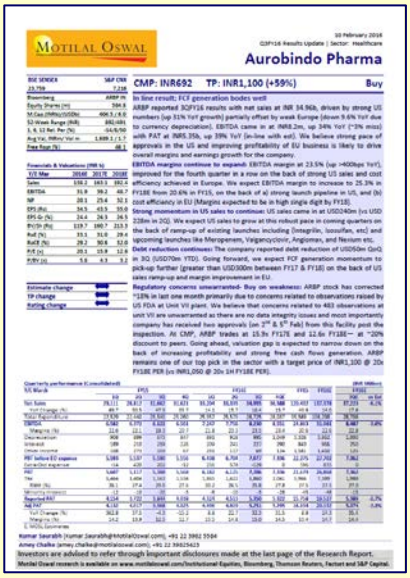
Y/E Mar	2011	2012	2013	2014	2015	2016	2017E	2018E
Adjusted EBITDA	9,598	6,101	8,610	22,828	25,636	30,773	38,986	48,448
Non cash opr. exp (inc)	252	247	285	232	808	682	800	1,200
(Inc)/Dec in Wkg. Cap.	-6,409	-1,288	-5,374	-13,533	-2,515	-6,939	-11,997	-18,244
Tax Paid	-2,251	-327	-132	-3,635	-5,966	-7,444	-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	-680	-1,762	-1,360
CF from Fin. Activity	**2,060**	**5,998**	**1,608**	**520**	**-73**	**2,498**	**-6,298**	**-5,025**
Inc/(Dec) in Cash	**1,139**	**-1,159**	**1,376**	**-298**	**2,906**	**3,652**	**1,446**	**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**	**8,344**	**9,790**	**16,304**

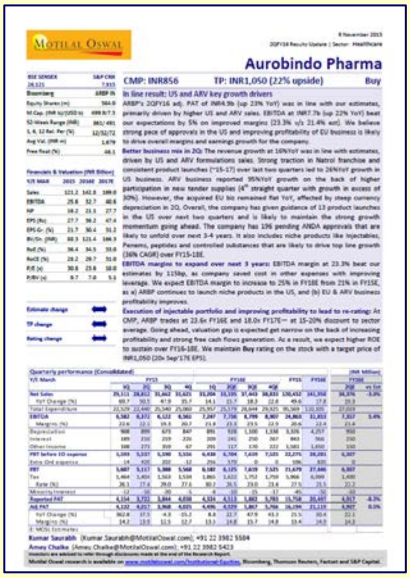
E: MOSL Estimates

AUROBINDO PHARMA GALLERY

AUROBINDO PHARMA







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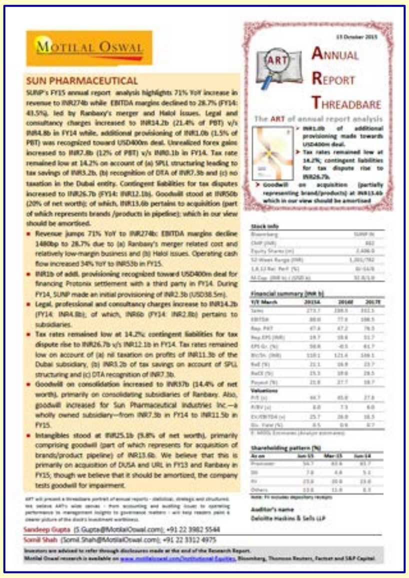
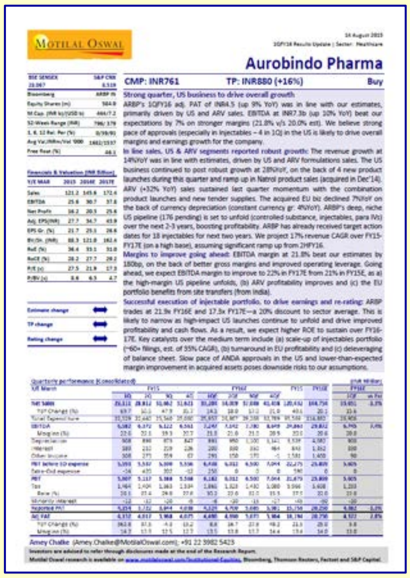
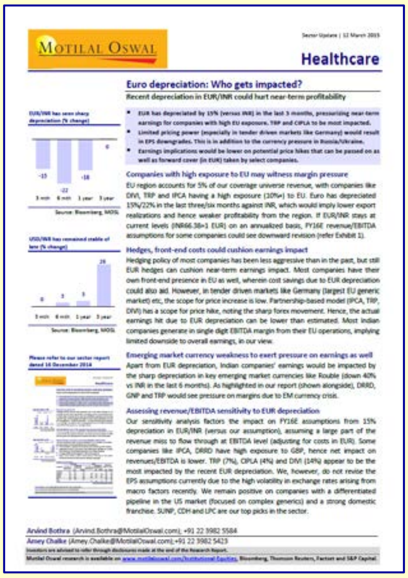




SECTOR UPDATES



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