

Sector: Pharmaceuticals
Company Update

	Change
Reco: Buy	↑
CMP: Rs. 799	
Price Target: Rs. 975	↔
↑ Upgrade ↔ No change ↓ Downgrade	

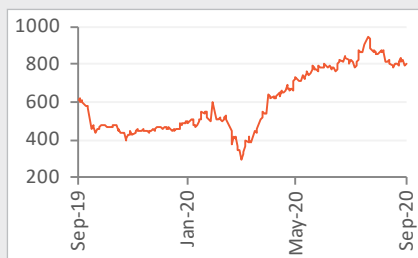
Company details

Market cap:	Rs. 46,801 cr
52-week high/low:	Rs. 967 / 281
NSE volume: (No of shares)	66.8 lakh
BSE code:	524804
NSE code:	AUROPHARMA
Sharekhan code:	AUROPHARMA
Free float: (No of shares)	28.1 cr

Shareholding (%)

Promoters	52.0
FII	22.8
DII	12.6
Others	12.66

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-6.7	1.6	130.2	30.1
Relative to Sensex	-4.9	-6.5	104.1	30.8

Sharekhan Research, Bloomberg

Aurobindo Pharma Limited (Aurobindo) is witnessing improved traction in its US business, which constitutes around half of overall sales. Aurobindo is one of the few pharmaceutical companies reporting an impressive performance in the US as compared to others, which have been facing challenges. The US business is expected to grow in double digits going ahead. A combination of factors, including a sturdy new product pipeline, easing of pricing pressures, opportunities arising from shortage of products in the US, and an expected recovery in the injectable business would be key drivers for the US business. In FY2021, Aurobindo plans to launch 50 new products in the US (including injectables), while it has already launched around 34 new products in FY2020. The new launches would bring in incremental revenue for the company. Aurobindo also has plans to file for 50-55 new products in FY2021 with the USFDA, which would enable it to maintain the new product launch momentum going ahead as well. Clearing of Unit 4 by USFDA in April 2020 provides ample visibility on new product pipeline. Performance of other geographies, i.e. Europe, is expected to improve gradually. With strong earnings growth and reducing debt, Aurobindo has strengthened its financial muscle. Management expects to have zero long-term debt over the next two years. Aurobindo's four plants are under USFDA scanner. The company has submitted its responses to the regulator and is awaiting a revert. Successful clearance of the plants is a key point to watch for and could result in further earnings upgrades. In addition, Aurobindo has collaborated with Council of Scientific and Industrial Research (CSIR) for developing COVID-19 vaccine. Moreover, independently, through its US subsidiary, Auro Vaccines, the company is developing a COVID-19 vaccine. Successful development and approval of the vaccine could unlock substantial growth opportunities.

Our Call

Valuations attractive; Upgrade to Buy: Aurobindo has a higher exposure (around 80%) to the regulated markets of US and Europe. In the process, the company has built strong capabilities to cater to these markets. Unit 4 clearance by the USFDA offers better growth visibility. Aurobindo has a sturdy ecosystem in generics (vertically integrated model, lower product concentration) to withstand volatility in the US. A testimony to this is sturdy performance in Q1FY2021. Strong traction in the US and gradual pick up in the other geographies would support topline growth, while steady margin improvement would result in double-digit earnings growth. Aurobindo's sales and PAT are expected to report 9.2% and 11.5% CAGR, respectively, over FY2020-FY2023. This coupled with improving balance sheet strength bodes well. At the CMP, the stock trades at an attractive valuation of 13.1x/11.6x its FY2022/FY2023E EPS, which is lower than its peers. Improving growth prospects, better earnings visibility, and strengthening balance sheet would support P/E multiple expansion. Further, the stock price has corrected by around 16% in a little over the past one month. This would provide a good entry point for investors. We upgrade our recommendation on Aurobindo to Buy from Hold and retain our PT of Rs. 975.

Key Risks

- 1) Delay in resolution of USFDA issues and product approvals can impact growth prospects.
- 2) Any adverse change in the regulatory landscape can impact earnings.

Valuation (Consolidated)

Particulars	Rs cr				
	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Total Income	19563.6	23098.0	25050.9	27328.5	30100.8
Operating profit	3952.0	4863.8	5461.1	6066.9	6802.8
OPM (%)	20.2	21.1	21.8	22.2	22.6
Adj. PAT	2513	2913	3289	3571	4038
EPS (Rs.)	42.9	49.7	56.1	61.0	68.9
PER (x)	18.6	16.1	14.2	13.1	11.6
EV/EBIDTA (x)	13.5	10.2	8.7	7.3	5.9
P/BV (x)	3.4	2.8	2.4	2.0	1.7
ROCE (%)	16.8	17.7	19.5	19.5	19.7
RONW (%)	19.7	19.0	17.9	16.6	16.0

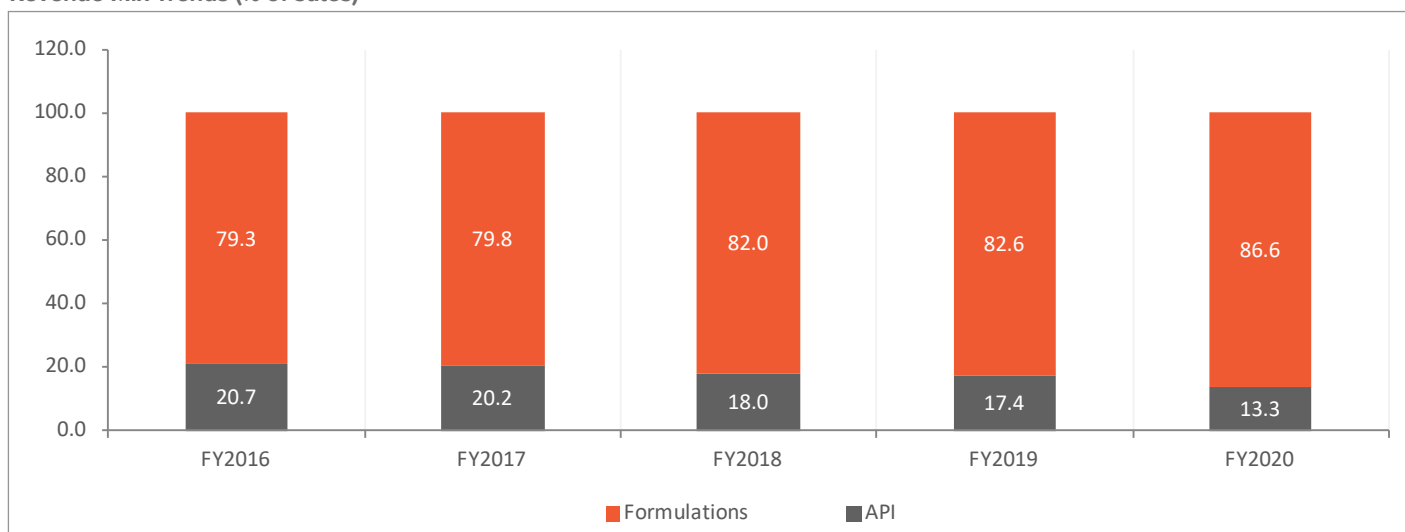
Source: Company; Sharekhan estimates

US business standing strong backed by sturdy new launches and robust outlook: Aurobindo has a sizeable presence in the US pharma markets. US constitutes 50% of the company's overall revenue. Aurobindo has bucked the industry trend and has managed to grow its US revenue for the quarter ending June 2020, primarily led by market share gains. The outlook for US business is strong and Aurobindo is well placed to harness the opportunities. Despite weakness in sales of Auro Medics, the company's revenue in the US grew by 6.5% y-o-y in constant currency terms for quarter ending June 2020. This can be attributed to volume growth in oral solids and new business opportunities, which continue to emerge in the US market due to manufacturing and supply disruptions faced by competitors. The company expects the generic injectable business in the US to recover from COVID-related disruptions over the next 2-3 quarters and attain its growth trajectory. In addition to this, the company has a strong pipeline of 59 ANDAs coupled with 80-90 products, which are under various stages of development. Moreover, to support growth, Aurobindo is in the process of adding 5-6 production lines for the injectable business, which is likely to be ready by the end of FY2021. Overall, Aurobindo has charted a strong growth map for the US business, backed by a sturdy launch pipeline. The company expects to launch 50-60 new products in the US markets in FY2021 after the launch of 34 new products in FY2020. In Q1FY2021, the company has already launched six new products, including one injectable product. Further, the company looks to file for 50-55 new products over the next two years, which would keep growth momentum going as opportunities unfold. Moreover, concerns around price erosion in the US generic markets seem to be stabilising, and this augurs well for the company. Going ahead, improved traction in new business enquiries for shortage of products as well as in market products in the US, robust new product pipeline, likely revival of the injectables business would support the growth in the US business.

Resolution for four units awaited from the USFDA; Corrective actions done: Aurobindo has undergone multiple USFDA inspections in the previous two years. The company's four facilities are under the USFDA scanner classified as OAI/WL. Plants 1 and 9, which are the API/intermediate plants, have been classified as an Official Action Initiated (OAI) along with plant 7, while Plant 11 is under a warning letter (WL) status. The company has largely completed corrective and preventive action at these plants and has submitted its responses to the regulator. A revert from the regulator is awaited. In light of COVID-19 pandemic, the USFDA had halted inspections of foreign plants. Hence, the company had requested for a desktop audit. Recently, in April 2020, USFDA cleared Aurobindo's plant 4, which had a substantial quantum of fillings. With the approval of Unit 4, regulatory concerns have eased out, though partially. Resolution of USFDA concerns at unit 1, 9, 11, and 7 will be critical from growth perspective and, upon approval it could lead to upward revision of earnings estimates.

Share of revenue from lucrative formulations segment increases: Aurobindo has two distinct business segments viz. – Active Pharmaceutical Ingredients (API) and formulations. The company is one of the leading manufacturers of APIs, which are primarily used to support its formulations business. API business is backed by a technologically advanced API research and development infrastructure, which develops new products and is engaged with clients up to delivery of products to the market. The company is among the few players present across beta lactams and non-beta lactams. In beta lactams, the company offers both sterile and non-sterile penicillin and cephalosporins along with penams.

Revenue Mix Trends (% of sales)



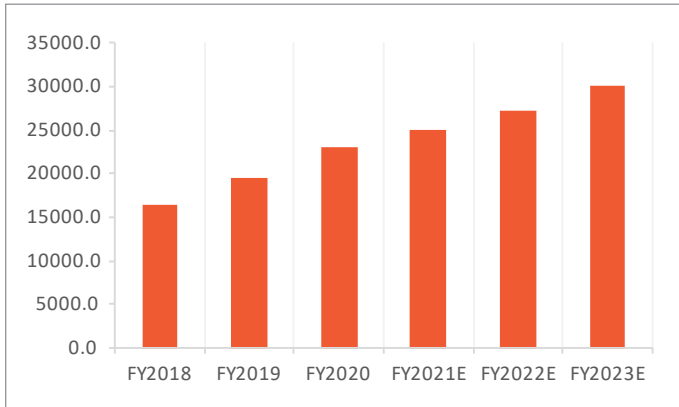
Source: Company; Sharekhan research

Over the years, Aurobindo's revenue mix has improved. Share of revenue from the formulations segment has increased. Over FY2016-FY2020, the proportion of formulations sales has risen to 86.6% from 79.3%. Transformation in revenue mix augurs well as formulations command a higher margin as compared to APIs. Further, the API segment is in a good shape and has good visibility on order book. The company is working on large-module API capacities to meet increasing demand for APIs. Therefore, improving revenue mix would support margin expansion, while better order book visibility and new DMF filings would support the API segment's growth.

Financials improving; Balance sheet gaining strength: Aurobindo's financials are on an improving trend. Performance of June quarter too was strong. The company has been able to grow its US business despite COVID-19 related disruptions. Strong performance in the US is expected to continue and would be backed by sturdy new launch pipeline. Further, increasing share of new launches and a favourable revenue mix would support margin expansion. Sales and earnings are expected to grow by 9.2% and 11.5% CAGR, respectively, over FY2020-FY2023. In April 2020, the company had announced a withdrawal from a major acquisition deal. This has removed the overhang of a likely increase in debt levels. Aurobindo had since then focused heavily on reduction in debt. As of Q1FY2021, the company had reduced by \$168 million q-o-q to \$191 million. Over the long term, the company is aiming for zero long-term debt levels. Aurobindo's debt:equity stood at 0.32 as of FY2020, which is expected to reduce to 0.12 by FY2023.

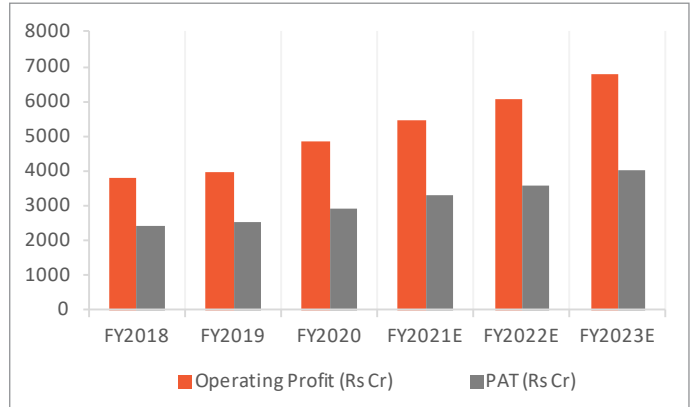
Financials in charts

Sales Trends (Rs Cr)



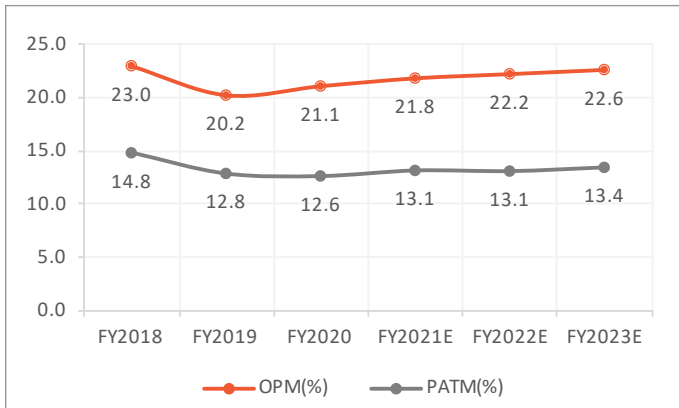
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



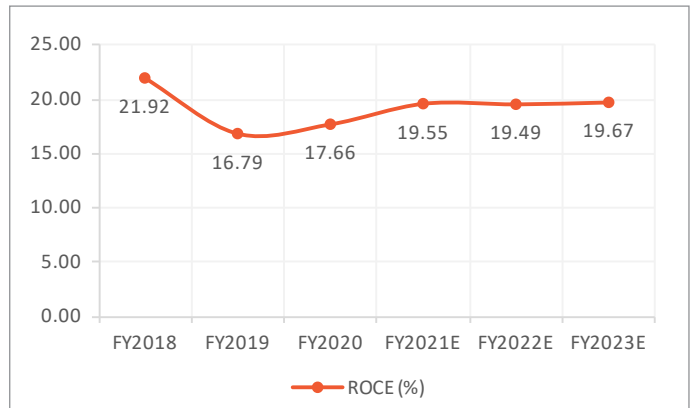
Source: Company, Sharekhan Research

OPM's to improve



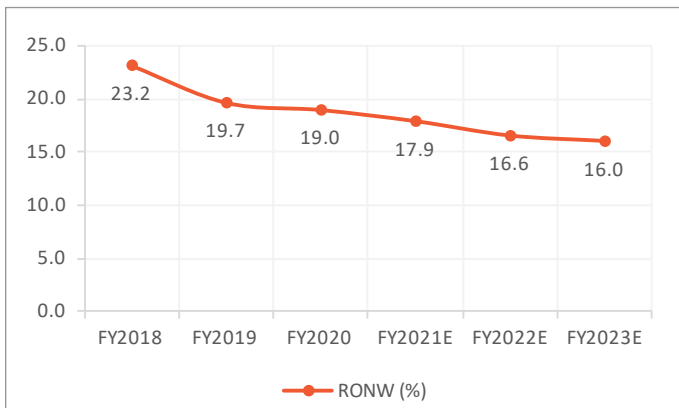
Source: Company, Sharekhan Research

ROCE Trends (%)



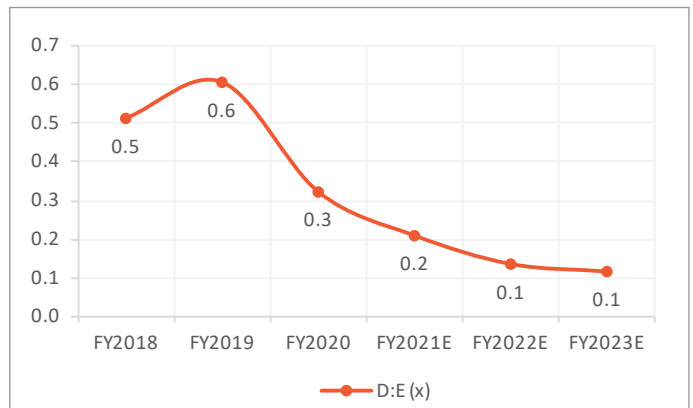
Source: Company, Sharekhan Research

RONW Trends (%)



Source: Company, Sharekhan Research

Debt : Equity (x)



Source: Company, Sharekhan Research

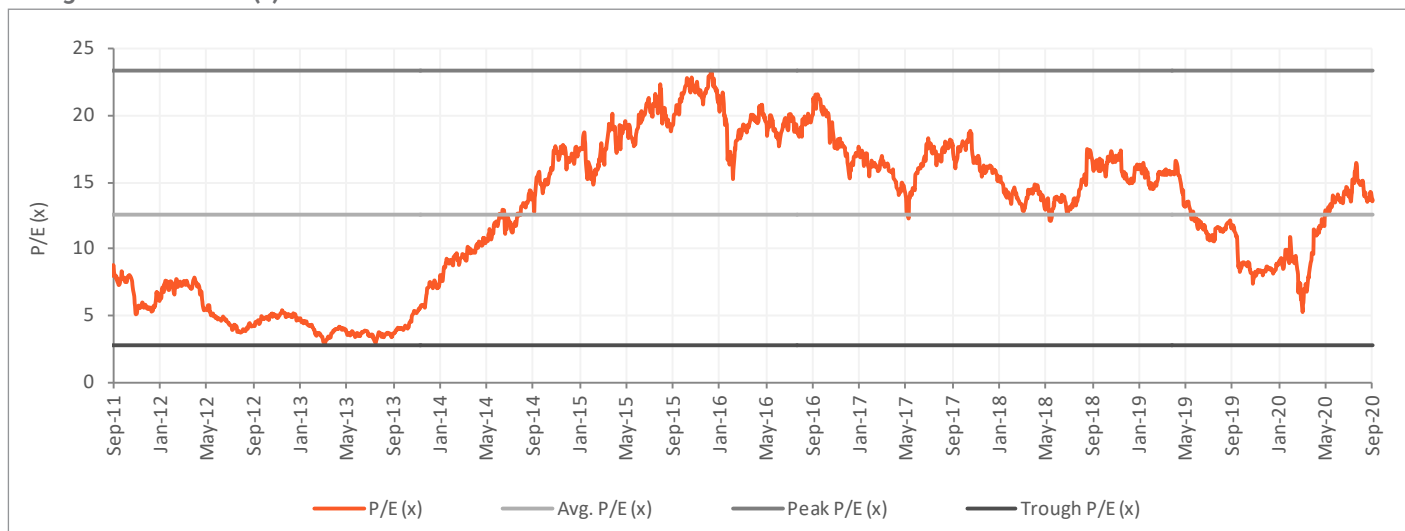
Outlook

US business gradually improving: Aurobindo is a leading Indian pharmaceutical company present in the formulations as well as the API space. The company is a leading player in the generics space in the US markets. Aurobindo derives around 80% of its revenue from developed markets of the US and Europe. Of late, regulatory pressures seem to be easing a bit with USFDA clearing Unit-4, which had a sizeable chunk of products linked to it. Moreover, the company has been able to gain market share in the US, with revenue registering strong double-digit growth for the quarter ending June. Going ahead, management expects traction in the US business to continue, backed by a strong product launch pipeline and relatively easing of pricing pressures in US generic market. However, the company is yet to get USFDA clearance for four of its plants; and so new product approvals from the plants are held up. A successful resolution of USFDA observations would be a key monitorable and a trigger for earnings upgrade. Over the long term, Aurobindo is looking to build its presence in the biosimilars space, which provides growth visibility going ahead.

Valuation

Valuations attractive; Upgrade to Buy: Aurobindo has a higher exposure (around 80%) to the regulated markets of US and Europe. In the process, the company has built strong capabilities to cater to these markets. Unit 4 clearance by the USFDA offers better growth visibility. Aurobindo has a sturdy ecosystem in generics (vertically integrated model, lower product concentration) to withstand volatility in the US. A testimony to this is sturdy performance in Q1FY2021. Strong traction in the US and gradual pick up in the other geographies would support topline growth, while steady margin improvement would result in double-digit earnings growth. Aurobindo’s sales and PAT are expected to report 9.2% and 11.5% CAGR, respectively, over FY2020-FY2023. This coupled with improving balance sheet strength bodes well. At the CMP, the stock trades at an attractive valuation of 13.1x/11.6x its FY2022/FY2023E EPS, which is lower than its peers. Improving growth prospects, better earnings visibility, and strengthening balance sheet would support P/E multiple expansion. Further, the stock price has corrected by around 16% in a little over the past one month. This would provide a good entry point for investors. We upgrade our recommendation on Aurobindo to Buy from Hold and retain our PT of Rs. 975.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
AurobindoPharma	799.0	58.6	46,802.0	16.1	14.2	13.1	10.2	8.7	7.3	19.0	17.9	16.6
Lupin	1040	45.3	47,128.0	133.6	37.0	28.8	22.3	16.2	12.7	2.8	9.2	10.6

Source: Sharekhan Research

About company

Hyderabad-based Aurobindo was incorporated in 1986. The company manufactures generic formulations and APIs. Aurobindo generates 90% of its sales from international markets. The company currently 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. The company also holds a strong position in many European countries, including France and Italy, where it ranks among the largest generic companies. Aurobindo is a vertically integrated company, meeting around 70% of its API requirements in-house. Aurobindo has 26 manufacturing facilities for its APIs and formulations businesses, which have requisite approvals from various regulatory authorities, including the USFDA, U.K. MHRA, Japan PMDA, WHO, Health Canada, MCC South Africa, and ANVISA Brazil.

Investment theme

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 strong momentum of new launches and fillings is expected to sustain going ahead as well, which offers substantial growth opportunities for the company. Aurobindo has completed its remedial actions at four of its plants and is awaiting a revert on the same from the USFDA. Clearance from the regulator would be a key point to watch for as it could result in earnings upgrades. Moreover, Aurobindo is involved in the development of COVID-19 vaccine and any favourable outcome would open up substantial growth potential for the company.

Key Risks

Delay in product approvals; change in regulatory landscape; and negative outcome of key facility inspections by the USFDA can affect earnings prospects.

Additional Data

Key management personnel

K Nithyananda Reddy	Vice - Chairman, Whole-time Director, One of the promoters.
N Govindarajan	Managing Director
P.V. Ramaprasad Reddy	Non-executive Director, Promoter
Santhanam Subramanian	CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co Ltd	6.3
2	Axis Clinicals Ltd	3.0
3	Vanguard Group Inc/The	1.7
4	BlackRock Inc	1.3
5	Dimensional Fund Advisors LP	1.1
6	Reliance Capital Trustee Co Ltd	1.1
7	SBI Funds Management	0.9
8	ICICI Prudential Life Insurance Co	0.7
9	Invesco	0.5
10	Norges Bank	0.5

Source: Bloomberg

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