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Aurobindo Pharma Ltd (Auro) is one of the largest vertically integrated pharmaceutical companies. Over the past few years, the company has drastically shifted its focus from APIs business to generic formulations.

🔗 **Robust growth in Europe, US and RoW business drives revenue:** Auro reported 11% YoY increase in net sales on the back of robust growth in Europe (up 37% YoY), US (up 12.8% YoY) and RoW (up 33.2% YoY) markets. Formulations business (contributes 82% of the total revenues) registered 14% YoY growth in Q3FY18 led by US business (contributes 46% to the total revenue) which reported a growth 12% YoY despite pricing pressure. The growth was driven by new product launches in both oral and injectable segments and strong volume growth in existing products. The company filed 2 ANDAs, launched 8 products and received final approval for 20 ANDAs and tentative approval for two ANDAs in Q3FY18. We expect the launch momentum to continue going ahead considering the robust product pipeline and steady approval rate. The company is targeting 25 product launches in the next six to nine months in Orals and key generic launches including Vancomycin, Toprol XL and Ertapenem. Hence, we expect US sales to grow at a CAGR of 9% over FY17-19E.

🔗 **New product launches to drive Europe business:** Europe formulations business (contributes 26% to total revenue) grew strongly by 37% YoY in Q3FY18 supported by integration of Portugal acquisition coupled with strong growth in key markets including Germany, UK, France and Spain and increase in tender business. So far, the company has transferred manufacturing of 78 products (out of 112) to India from Europe leading to cost optimization. We expect growth momentum to continue going forward with 16% CAGR over FY17-20E driven by new product launches. The company is planning to launch Oncology products in Europe in FY19. Importantly, the company has over 200 products under development for Europe. Revenues from ARV business (represents 7% of the overall revenues) continued to decline (down 30% YoY) on the back of pricing pressure in key products (Tenofovir, Lamivudine and Efavirenz (TLE)). However, on a sequential basis, this business registered 15% growth due to launch of Dolutegravir combination.

🔗 **EBITDA margin expanded by 74 bps YoY to 23.7%; to moderate going ahead:** EBITDA rose by 15% YoY leading to EBITDA margin expansion to 74bps in Q3FY18 on the back the favorable product mix. Going ahead, we expect EBITDA margin to moderate due to higher R&D expenses on the back of increase in filings and lack of blockbuster launches like gZetia in FY18. Adj. Pat grew by just 3% YoY as higher depreciation (up 24% YoY) and tax charges (up 41% YoY) restricted the growth.

Outlook and Valuation:

We believe Aurobindo Pharma is better placed as compared to its peers on the back of relatively better performance despite pricing pressure in the US. We expect revenue and PAT to grow at a CAGR of 9.5%/7% over FY17-20E on the back of new product launches mainly in complex generics, volume growth in existing products and ramp-up in Europe business. Importantly, recent observations of the USFDA to its unit-IV facility (which makes injectables) at Hyderabad, remains a concern. The USFDA has issued Form 483 with 9 observations to the company's unit 4, citing deficiencies in maintaining manufacturing standards. However, none of the observations are related to data integrity or are repetitive in nature. We recommend 'BUY' rating on the stock with a target price of Rs 644 based on 13.5x FY20E EPS.

Market Data

Rating	BUY
CMP (Rs.)	582
Target (Rs.)	644
Potential Upside	11%
Duration	Long Term
Face Value (Rs.)	1
52 week H/L (Rs.)	809/504
Decline from 52WH (%)	28%
Rise from 52WL (%)	15%
Beta	0.8
Mkt. Cap (Rs.Cr)	34,099

Fiscal Year Ended

Y/E	FY17	FY18E	FY19E	FY20E
Revenue (Rs.Cr)	14,910	16,655	18,227	19,555
Adj. profit (Rs.Cr)	2,302	2,595	2,577	2,793
Adj. EPS (Rs.)	39.3	44.3	44.0	47.7
P/E (x)	14.8	13.1	13.2	12.2
P/BV (x)	3.6	2.9	2.4	2.0
ROE (%)	27.6	24.5	19.8	18.0

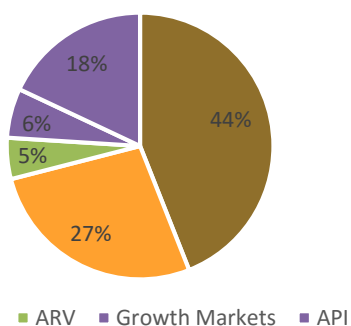
Shareholding Pattern

	Jun-17	Sep-17	Dec-17
Promoters	51.9	51.9	51.9
FII's	19.6	18.8	18.9
MFs/Insti	14.2	15.3	15.5
Public	10.0	9.7	9.7
Others	4.3	4.3	4.0

Aurobindo Pharma Ltd: Business overview

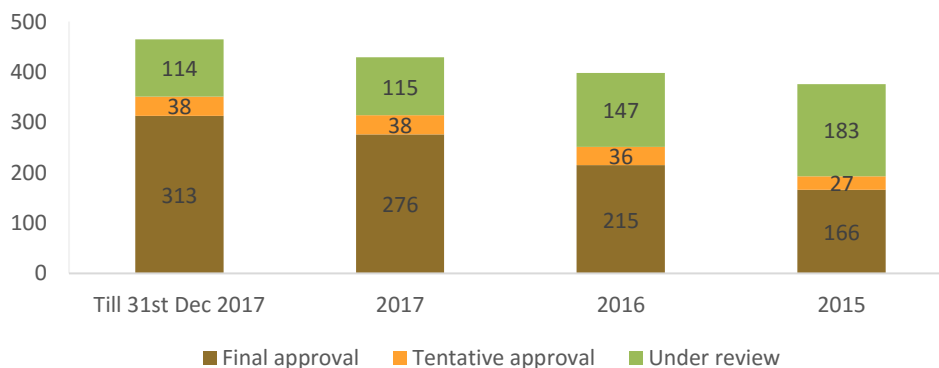
Aurobindo Pharma Ltd (Auro) is one of the largest vertically integrated pharmaceutical companies. Over the past few years, the company has drastically shifted its focus from APIs business to generic formulations. The company's robust product portfolio is spread over 6 major therapeutic/product areas encompassing Antibiotics, Anti-Retroviral, CVS, CNS, Gastroenterological, Pain management and Anti-Allergic, supported by an outstanding R&D set-up. Aurobindo exports to over 125 countries across the globe with more than 70% of its revenues derived out of international operations. The company reinforced its presence in Western Europe with both manufacturing and marketing footprint with the acquisition of Generis as well as branded products.

Revenue breakup- Segment wise



Source: Company, In-house research

US Filings snapshot



(Rs cr)	Q3FY18	Q3FY17	YoY		QoQ		9MFY18	9MFY17	% Chg
			Growth %	Q2FY18	Growth %				
US	1,910	1,745	9.4	2,099	(9.0)	5,703	5,184	10.0	
Europe	1,172	855	37.0	1,113	5.2	3,203	2,500	28.1	
RoW	250	188	33.2	243	2.8	687	558	23.1	
ARVs	239	342	(30.1)	208	15.1	691	924	(25.2)	
Total Formulations	3,570	3,130	14.1	3,663	(2.5)	10,285	9,166	12.2	
APIs	766	776	(1.3)	772	(0.8)	2,163	2,279	5.1	
Total sales	4,336	3,906	11.0	4,436	(2.2)	12,447	11,445	8.8	

Investment Rationale

Growth in its formulations business drives revenue

Auro reported 11% YoY increase in net sales on the back of robust growth in Europe (up 37% YoY), US (up 12.8% YoY) and RoW (up 33.2% YoY) markets. Formulations business (contributes 82% of the total revenues) registered 14% YoY growth in Q3FY18 led by US business (contributes 46% to the total revenue) which reported a growth 12% YoY despite pricing pressure. The growth was driven by new product launches in both oral and injectable segments and strong volume growth in existing products. The company filed 2 ANDAs, launched 8 products and received final approval for 20 ANDAs and tentative approval for two ANDAs in Q3FY18. On a cumulative basis, Auro filed 465 ANDAs with USFDA and received 351 approvals. Aurobindo USA, the company marketing oral products in the US witnessed growth of 17% YoY driven by pick up in new launches while AuroMedics, the injectable business clocked growth of 9% YoY. We expect the launch momentum to continue going ahead considering the robust product pipeline and steady approval rate. The company is targeting 25 product launches in the next six to nine months in Orals and key generic launches including Vancomycin, Toprol XL and Ertapenem. Hence, we expect US sales to grow at a CAGR of 9% over FY17-19E.

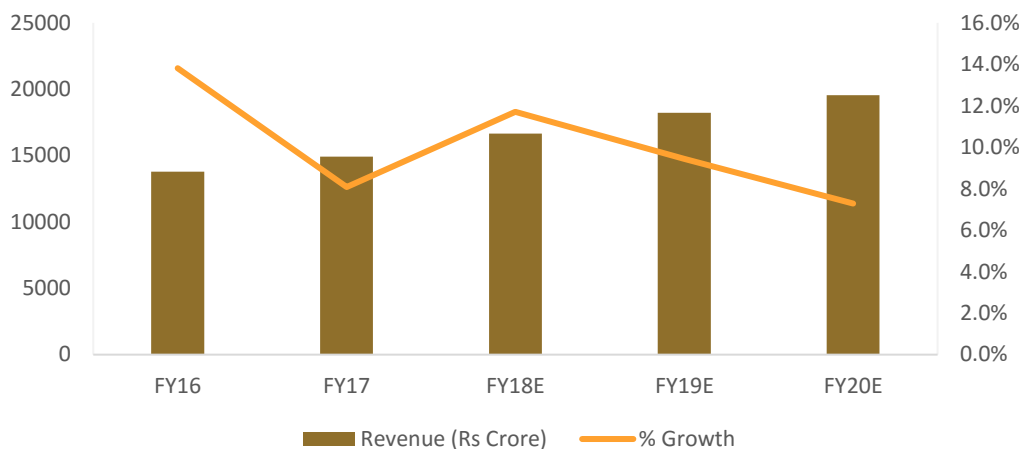
New product launches to drive Europe business

Europe formulations business (contributes 26% to total revenue) registered strong 37% YoY growth in Q3FY18 supported by integration of Portugal acquisition coupled with strong growth in key markets including Germany, UK, France and Spain and increase in tender business. So far, the company has transferred manufacturing of 78 products (out of 112) to India from Europe leading to cost optimization. We expect growth momentum to continue going forward with 16% CAGR over FY17-20E driven by new product launches. The company is planning to launch Oncology products in Europe in FY19. Importantly, the company has over 200 products under development for Europe. Revenues from ARV business (represents 7% of the overall revenues) continued to decline (down 30% YoY) on the back of pricing pressure in key products (Tenofovir, Lamivudine and Efavirenz (TLE)). However, on a sequential basis, this business registered 15% growth due to launch of Dolutegravir combination. Rest of the World registered robust 33% YoY growth driven by strong growth in Canada and bounce back in Brazil sales

EBITDA margin expanded by 74 bps YoY to 23.7%; to moderate going ahead

EBITDA rose by 15% YoY leading to EBITDA margin expansion to 74bps in Q3FY18 on the back the favorable product mix. Going ahead, we expect EBITDA margin to moderate due to higher R&D expenses on the back of increase in filings and lack of blockbuster launches like gZetia in FY18. Adj. Pat grew by just 3% YoY as higher depreciation (up 24% YoY) and tax charges (up 41% YoY) restricted the growth. On the capex front, the company has guided capex of USD120-130 mn for FY18 excluding biosimilars and vaccines.

Revenue to grow at 9.5% CAGR over FY17-20E



Outlook and Valuation

We believe Aurobindo Pharma is better placed as compared to its peers on the back of relatively better performance despite pricing pressure in the US. We expect revenue and PAT to grow at a CAGR of 10%/7% over FY17-20E on the back of new product launches mainly in complex generics, volume growth in existing products and ramp-up in Europe business. Importantly, recent observations of the USFDA to its unit-IV facility (which makes injectables) at Hyderabad, remains a concern. The USFDA has issued Form 483 with 9 observations to the company's unit 4, citing deficiencies in maintaining manufacturing standards. However, none of the observations are related to data integrity or are repetitive in nature. We recommend 'BUY' rating on the stock with a target price of Rs 644 based on 13.5x FY20E EPS.

Key Risks

- Pricing pressure in the US markets.
- Economic and political instability arising from changes in foreign policies & political leadership in countries like US, Europe and emerging markets as the company generates 88% of total revenue from international markets.
- Increasing competition to lead to price war.
- Regulatory, Statutory & Legal compliance risks

Profit & Loss Account (Consolidated)

Y/E (Rs. Cr)	FY17	FY18E	FY19E	FY20E
Total operating Income	14,910	16,655	18,227	19,555
Raw Material cost	6,434	6,882	7,965	8,495
Employee cost	1,768	1,975	2,163	2,322
Other operating expenses	3,273	3,719	4,016	4,310
EBITDA	3,434	4,079	4,083	4,427
Depreciation	428	550	669	746
EBIT	3,007	3,529	3,414	3,681
Interest cost	67	75	58	42
Other Income	116	77	81	86
Profit before tax	3,056	3,531	3,436	3,724
Tax	760	936	859	931
Profit after tax	2,296	2,595	2,577	2,793
Minority Interests	(0)	-	-	-
P/L from Associates	5	-	-	-
Adjusted PAT	2,302	2,595	2,577	2,793
E/o income / (Expense)	-	-	-	-
Reported PAT	2,302	2,595	2,577	2,793

Balance Sheet (Consolidated)

Y/E (Rs. Cr)	FY17	FY18E	FY19E	FY20E
Paid up capital	59	59	59	59
Reserves and Surplus	9,313	11,733	14,135	16,752
Net worth	9,372	11,792	14,193	16,810
Minority interest	2	2	2	2
Total Debt	3,084	2,884	2,258	1,638
Other non-current liabilities	-	-	-	-
Total Liabilities	12,458	14,678	16,453	18,451
Total fixed assets	4,427	6,836	7,167	7,421
Capital WIP	1,458	500	500	500
Goodwill	406	406	406	406
Investments	246	246	246	246
Net Current assets	5,470	6,239	7,684	9,427
Deferred Tax assets (Net)	118	118	118	118
Other non-current assets	332	332	332	332
Total Assets	12,458	14,678	16,453	18,451

Cash Flow Statement (Consolidated)

Y/E (Rs. Cr)	FY17	FY18E	FY19E	FY20E
Pre tax profit	3,061	3,531	3,436	3,724
Depreciation	428	550	669	746
Chg in Working Capital	563	(570)	(707)	(488)
Others	1	(2)	(23)	(43)
Tax paid	(774)	(936)	(859)	(931)
Cash flow from operating activities	3,279	2,573	2,517	3,008
Capital expenditure	(1,685)	(2,000)	(1,000)	(1,000)
Chg in investments	(118)	-	-	-
Other investing cashflow	15	77	81	86
Cash flow from investing activities	(1,787)	(1,923)	(919)	(914)
Equity raised/(repaid)	7	-	-	-
Debt raised/(repaid)	(1,728)	(200)	(626)	(620)
Dividend paid	(137)	(176)	(176)	(176)
Other financing activities	(57)	(75)	(58)	(42)
Cash flow from financing activities	(1,915)	(450)	(860)	(838)
Net chg in cash	(424)	199	738	1,255

Key Ratios (Consolidated)

Y/E	FY17	FY18E	FY19E	FY20E
Growth (%)				
Net Sales	8.2	11.7	9.5	7.3
EBITDA	7.7	18.8	0.1	8.4
Net profit	13.7	12.8	-0.7	8.4
Margin (%)				
EBITDA	23.0	24.5	22.4	22.6
NPM	15.4	15.6	14.1	14.3
Return Ratios (%)				
RoE	27.6	24.5	19.8	18.0
RoCE	25.8	26.6	22.5	21.6
Per share data (Rs.)				
EPS	39.3	44.3	44.0	47.7
DPS	2.5	2.5	2.5	2.5
Valuation(x)				
P/E	14.8	13.1	13.2	12.2
EV/EBITDA	10.7	8.9	8.6	7.5
EV/Net Sales	2.5	2.2	1.9	1.7
P/B	3.6	2.9	2.4	2.0
Turnover Ratios (x)				
Net Sales/GFA	3.1	2.4	2.1	2.0
Sales/Total Assets	0.9	0.9	0.9	0.9

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	Buy	More than equal to 15%
Hold	Upside or downside is less than 10%	Accumulate*	Upside between 10% & 15%
Reduce	Less than equal to -10%	Hold	Between 0% & 10%
		Reduce/sell	Less than 0%

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

* Aurobindo Pharmaceuticals Limited is a large-cap company.

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