

**BUY**

November 12, 2012

# Aurobindo Pharma

Sector outlook: Positive

Pharmaceuticals

**Target price: Rs 239**

**CMP: Rs 179\***

**Upside: 33.8%**

\*Price as on November 12, 2012

524804	Sensex: 18,670
AUROBINDOP	Nifty: 5,684
ARBN.BO	52 W-H/L: 181/80
ARBP.IN	Face Value-Rs 1

Market cap (Rs mn)	52,108
Daily vol. (3M NSE avg.)	347,616
Current share O/S (mn)	2,911
Diluted shares (mn)	2,911
Promoters holding (%)	54.76
Pledged shares (%)	11.78

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Aurobindo reported excellent Q2FY13 results.

**Result Highlights**

- > Led by its formulations business, total income surged 39.5% YoY to Rs15bn.
- > EBITDA margin expanded by a staggering 602bps YoY and 517 bps QoQ to 16.7%, primarily due to significant improvement in sales and increase in contribution from the higher-margin formulations space.
- > APAT increased by 144% YoY, which was mainly inline with EBITDA.
- > We retain our BUY rating with an upgraded target price of Rs239 (earlier: Rs185).

**US formulations business back on track**

Led by series of ANDA launches and favorable exchange rate during Q2FY13, US formulations sales growth was robust at 50% YoY. The company witnessed massive improvement in the US business in comparison to the preceding quarters. Aurobindo has started receiving ANDA approvals for products from Unit III. USFDA inspection for Unit IV and Unit VI is over and we believe the clearance for both units would be given by Q4FY13. The USFDA inspectors have not made any adverse observation about Unit IV. Though some observations have been made about Unit VI, the management says they are not very serious. Both the facilities are in injectible space, clearance of which should aid them cash on the drug shortage situation in the injectibles space in US. Unit VI used to contribute USD32mn to sales before the USFDA's warning letter. Despite all the concerns, the company has managed to clock in strong growth in the US in Q2FY13.

**EU & RoW, and ARV formulation sales growth robust**

Sales in the EU and RoW grew by 82% YoY and the management expects them to remain strong going forward. The company is increasing its field force in EU and RoW markets which should maintain the strong growth momentum in the region. ARV sales saw a revival and grew by 36.6% YoY as supplies remained strong during the quarter. Company is currently focusing more on profitability in the APR space.

**APIs post good all-round growth**

API segment also posted excellent 26.9% growth YoY as the company posted excellent growth across business segments. SSP and Ceph sales signalled improvement in growth rate as they grew by 22.9% and 32.3%, respectively. This segment would receive further fillip once Unit VI gets clearance as it also houses injectible APIs. Non-SSP and non-cephalosporin segment grew by 25.1% YoY and would be a main segment in APIs, going forward.

**Valuation:** We expect the growth in the US formulations segment to remain high, at least for the next two years, led by capacity enhancements and increase in patent expiries in FY13. The company's foray into segments like injectables, oral contraceptives and controlled substances augurs well for margins in the long run. Clearance for Unit VI and Unit IV will also add on to the margins since unutilized overheads would get utilized. At the CMP of Rs179 the stock is trading at 12.4x FY13E and 8.2x FY14E core EPS (excluding licensing income). We have raised our FY13-14 estimates after the results, and retain our **BUY** rating with a revised target price of Rs239 at 11x FY14E (core EPS excl. dossier income) from Rs185.

Key financials (Y/E March)			
(Rs mn)	FY12	FY13E	FY14E
Sales	46,274	57,366	69,615
Growth (%)	5.6	24.0	21.4
EBITDA	6,101	8,719	11,639
EBITDA (%)	13.2	15.2	16.7
Profit after tax	4,210	4,579	6,737
Growth (%)	(20.0)	8.8	47.1
Core EPS (Rs)	10.7	14.4	21.8

Source: Company, Fortune Research Estimates

Valuation/Ratios			
(x)	FY12	FY13E	FY14E
P/E	16.7	12.4	8.2
P/B	2.2	1.9	1.5
EV/EBITDA	12.7	8.9	6.5
EV/Sales	1.7	1.3	1.1
RoE (%)	13.0	16.4	20.6
RoCE (%)	6.7	9.8	12.7

Source: Company, Fortune Research Estimates

Quarterly financials (Consolidated)							
Y/E March (Rs mn)	Q2FY13	Q2FY12	Q1FY13	YoY (%)	QoQ (%)	Q2FY13E	Variance (%)
Net sales	14,887	10,600	12,076	40.4	23.3		
Other operating income	117	153	68				
<b>Total operating income</b>	<b>15,004</b>	<b>10,753</b>	<b>12,144</b>	<b>39.5</b>	<b>23.6</b>	<b>12,981</b>	<b>15.6</b>
Material costs	7,565	5,994	6,474				
% of sales	50.4	55.7	53.3				
Employee expenses	1,670	1,327	1,543				
% of sales	11.1	12.3	12.7				
Manufacturing & other expenditure	3,266	2,286	2,730				
% of sales	21.8	21.3	22.5				
<b>EBITDA</b>	<b>2,503</b>	<b>1,146</b>	<b>1,398</b>	<b>118.3</b>	<b>79.1</b>	<b>1,752</b>	<b>42.9</b>
<b>EBITDA (%)</b>	<b>16.7</b>	<b>10.7</b>	<b>11.5</b>	<b>602 bps</b>	<b>517 bps</b>	<b>13.5</b>	<b>319 bps</b>
Dep. and amortization	598	462	588				
Interest	335	207	331				
EBT	1,570	477	478				
Other income	66	60	22				
Exceptional items	(1,177)	1,854	2,065				
<b>PBT</b>	<b>2,812</b>	<b>(1,317)</b>	<b>(1,564)</b>				
Provision for tax	591	(516)	(274)				
effective tax rate	36.2	-96.0	-54.8				
Minority interest	-4	0	-1				
<b>PAT (Reported)</b>	<b>2,224</b>	<b>(802)</b>	<b>(1,289)</b>	<b>(377.4)</b>	<b>(272.5)</b>		
<b>Adjusted PAT</b>	<b>1,047</b>	<b>429</b>	<b>400</b>	<b>143.8</b>	<b>161.6</b>	<b>683</b>	<b>53.3</b>

Source: Company, Fortune Research

**Highlights of the post results concall:**

- The management expects to maintain margins at the current levels.
- Sales from MNC partners have been much better in Q2FY13 in comparison to Q1FY13. Management wants to grow its own brand name in US, which would reduce its dependence on partners.
- Management has indicated for 15 more launches in US for the 2HFY13 which should keep the growth rate going in the region.
- Management believes that the launch of ANDAs in Q1-Q2FY13 have done well, especially Modafinil and Montelukast sodium. Company had build in large inventory for Montelukast which resulted in better share. Modafinil has 7 ANDA approvals, but not all of them are active in the market.
- Combivir is likely to remain limited competition opportunity and management doesn't see any additional competitor in near term. Although volume has shrink by 10%-12% but the pricing has remained relatively stable. We expect the drug to generate sales of USD12mn in FY13 for the company.
- Company has launched Hydrocodone APAP in US and expects four more controlled substances approval in FY13.
- Management wants to concentrate more on non-ceph and SSP business in the API business, which would reduce the company's dependence on seasonality.
- Company will do capex of Rs1,000mn in FY13 combined with spillover capex of Rs1,250mn of last year.
- Current cost of debt for the company is 3.85% since majority of the debt is external.
- The management has guided for tax rate of 20% in FY14.

**Exhibit 1: Revised estimates**

	Revised estimates		Earlier estimates		% revision	
	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Total income (Rs mn)	57,366	69,615	52,724	61,885	8.8	12.5
YoY growth rate	24.0	21.4	13.9	17.4		
EBITDA (Rs mn)	8,719	11,639	7,256	9,753	20.2	19.3
EBITDA margin (%)	15.2	16.7	13.8	15.8	144 bps	96 bps
Adj. PAT (Rs mn)	4,196	6,337	3,080	4,894	36.2	29.5
EPS (Rs)	14.4	21.8	10.6	16.8	36.2	29.5

Source: Fortune Research Estimates

## Exhibit 02: Quarterly sales break up

(Rs mn)	Q2FY13	Q2FY12	Y-o-Y %
<b>Formulations</b>			
USA	4,249	2,833	50.0
EU & ROW	2,257	1,240	82.0
ARV	2,522	1,846	36.6
<b>Total fomulation sales</b>	<b>9,028</b>	<b>5,919</b>	<b>52.5</b>
Dossier income	117	153	(23.5)
<b>APIs</b>			
SSPs	1,846	1,502	22.9
Cephs	2,255	1,704	32.3
Non SSP and non-ceph	2,120	1,695	25.1
<b>Total APIs</b>	<b>6,221</b>	<b>4,901</b>	<b>26.9</b>
<b>Total sales</b>	<b>15,366</b>	<b>10,973</b>	<b>40.0</b>
<b>Total sales (excl. dossier income)</b>	<b>15,249</b>	<b>10,820</b>	<b>40.9</b>

Source: Company, Fortune Research

## Consolidated financial statements (Y/E March)

(Rs mn)

Income statement	FY10	FY11	FY12	FY13E	FY14E
<b>Total income</b>	<b>35,754</b>	<b>43,815</b>	<b>46,274</b>	<b>57,366</b>	<b>69,615</b>
<b>YoY (%)</b>	<b>16.2</b>	<b>22.5</b>	<b>5.6</b>	<b>24.0</b>	<b>21.4</b>
<b>Total expenses</b>	<b>27,523</b>	<b>34,217</b>	<b>40,173</b>	<b>48,647</b>	<b>57,976</b>
Cost of goods sold	17,211	21,893	25,198	31,009	37,461
Staff cost	2,916	3,846	5,357	6,828	8,087
R&D expenses	924	1,344	1,579	1,967	2,524
Administrative, selling and other expenses	2,944	3,027	3,086	3,394	3,802
Other manufacturing expenses	3,529	4,108	4,954	5,449	6,103
<b>EBITDA</b>	<b>8,232</b>	<b>9,597</b>	<b>6,101</b>	<b>8,719</b>	<b>11,639</b>
<b>YoY (%)</b>	<b>59.4</b>	<b>16.6</b>	<b>(36.4)</b>	<b>42.9</b>	<b>33.5</b>
<b>EBITDA (%)</b>	<b>23.0</b>	<b>21.9</b>	<b>13.2</b>	<b>15.2</b>	<b>16.7</b>
Depreciation	1,493	1,715	2,005	2,170	2,312
<b>EBIT</b>	<b>6,739</b>	<b>7,882</b>	<b>4,096</b>	<b>6,549</b>	<b>9,327</b>
Interest	678	625	1,028	1,224	1,199
Other income	297	250	247	241	265
Forex gains/(losses)	1,165	478	(2,233)	-	-
<b>PBT</b>	<b>7,523</b>	<b>7,985</b>	<b>1,082</b>	<b>5,567</b>	<b>8,394</b>
Less: Taxation	1,914	2,251	(888)	1,002	1,679
<b>Effective tax rate (%)</b>	<b>25.4</b>	<b>28.2</b>	<b>(82.1)</b>	<b>18.0</b>	<b>20.0</b>
Minority interest	3	4	6	15	22
<b>Recurring PAT</b>	<b>5,634</b>	<b>5,634</b>	<b>(1,235)</b>	<b>4,579</b>	<b>6,737</b>
<b>YoY (%)</b>	<b>462.0</b>	<b>0.0</b>	<b>(121.9)</b>	<b>470.8</b>	<b>47.1</b>
<b>PAT (%)</b>	<b>15.8</b>	<b>12.9</b>	<b>(2.7)</b>	<b>8.0</b>	<b>9.7</b>
<b>Reported PAT</b>	<b>4,447</b>	<b>5,260</b>	<b>4,210</b>	<b>4,579</b>	<b>6,737</b>

Source: Company, Fortune Research

Balance sheet	FY10	FY11	FY12	FY13E	FY14E
Equity capital	279	291	291	291	291
Reserves	18,012	24,157	23,105	27,344	33,740
<b>Net worth</b>	<b>18,291</b>	<b>24,448</b>	<b>23,397</b>	<b>27,635</b>	<b>34,031</b>
Minority interest	43	91	102	117	139
Total borrowings	21,546	17,581	25,728	25,840	24,685
Other liabilities	954	1,234	39	39	39
<b>Total liabilities</b>	<b>40,833</b>	<b>43,354</b>	<b>49,266</b>	<b>53,631</b>	<b>58,894</b>
<b>Gross block</b>	<b>24,077</b>	<b>24,336</b>	<b>30,377</b>	<b>32,877</b>	<b>35,377</b>
Less: Acc. depreciation	(6,968)	(6,405)	(7,976)	(10,145)	(12,458)
Net block	17,109	17,931	22,401	22,731	22,919
CWIP	5,701	6,030	6,000	6,575	7,075
<b>Investments</b>	<b>3</b>	<b>385</b>	<b>385</b>	<b>385</b>	<b>385</b>
<b>Current assets</b>	<b>25,059</b>	<b>34,334</b>	<b>33,536</b>	<b>39,263</b>	<b>45,792</b>
Inventories	11,025	14,553	15,456	18,231	21,361
Debtors	9,560	12,310	12,400	15,088	17,928
Cash and bank balances	728	1,867	709	707	1,053
Other current assets	33	266	743	778	817
Loans & Advances	3,713	5,338	4,230	4,458	4,632
Current liabilities	6,728	14,754	12,405	14,605	16,484
Provisions	352	614	706	777	854
<b>Net current assets</b>	<b>17,979</b>	<b>18,965</b>	<b>20,425</b>	<b>23,882</b>	<b>28,454</b>
<b>Total assets</b>	<b>40,833</b>	<b>43,354</b>	<b>49,266</b>	<b>53,631</b>	<b>58,894</b>

Source: Company, Fortune Research

Ratios	FY10	FY11	FY12	FY13E	FY14E
<b>Per share (Rs)</b>					
Diluted EPS (Rs)	19.4	19.4	(4.2)	15.7	23.1
Core EPS (Rs, excl. Dossier income)	10.2	11.8	10.7	14.4	21.8
CEPS (Rs)	24.5	25.2	2.6	23.2	31.1
Book value (Rs)	65.7	84.0	80.4	94.9	116.9
Dividend per share (Rs)	1.0	2.0	1.0	1.0	1.0
<b>Dividend Yield (%)</b>	<b>0.5</b>	<b>1.1</b>	<b>0.6</b>	<b>0.6</b>	<b>0.6</b>
<b>Leverage ratios</b>					
Net Debt Equity Ratio	1.1	0.6	1.1	0.9	0.7
<b>Operating performance</b>					
Inventory Days	101	107	118	107	104
Debtor Days	94	91	97	87	87
Fixed asset turnover	1.6	1.8	1.6	2.0	2.3
<b>Return ratios</b>					
<b>ROCE (%)</b>	<b>13.2</b>	<b>14.5</b>	<b>6.7</b>	<b>9.8</b>	<b>12.7</b>
<b>ROE (%)</b>	<b>19.4</b>	<b>16.0</b>	<b>13.0</b>	<b>16.4</b>	<b>20.6</b>
<b>Valuation Ratios</b>					
PE (x)	9.2	9.2	(42.2)	11.4	7.7
Core PE (x)	17.5	15.2	16.7	12.4	8.2
Cash P/E (x)	7.3	7.1	67.6	7.7	5.8
Price/book value (x)	2.7	2.1	2.2	1.9	1.5
Market cap/sales (x)	1.5	1.2	1.1	0.9	0.7
EV/sales (x)	2.0	1.6	1.7	1.3	1.1
EV/EBITDA (x)	8.9	7.1	12.7	8.9	6.5

Source: Company, Fortune Research

Cash flow	FY10	FY11	FY12	FY13E	FY14E
Net profit	5,634	5,634	(1,235)	4,579	6,737
Depn and w/o	1,493	1,715	2,005	2,170	2,312
Deferred tax	38	146	267	(1,216)	-
Change in working cap	(1,444)	(96)	(2,735)	(3,533)	(4,306)
Provisions & other adjustments	212	397	(1,371)	1,286	78
<b>Operating cash flow</b>	<b>5,932</b>	<b>7,796</b>	<b>(3,068)</b>	<b>3,287</b>	<b>4,820</b>
Capex	(4,952)	(2,866)	(6,446)	(3,076)	(3,000)
Investments	(0)	(383)	(0)	-	-
<b>Investing cash flow</b>	<b>(4,952)</b>	<b>(3,248)</b>	<b>(6,446)</b>	<b>(3,076)</b>	<b>(3,000)</b>
Dividend	(324)	(684)	(338)	(341)	(341)
Fresh issue + Change in share premium	10	13	-	-	-
Debt	(1,784)	(3,965)	8,148	112	(1,155)
Other financing activities	570	1,242	532	15	22
<b>Financing cash flow</b>	<b>(1,528)</b>	<b>(3,394)</b>	<b>8,342</b>	<b>(214)</b>	<b>(1,474)</b>
<b>Net change in cash</b>	<b>(548)</b>	<b>1,154</b>	<b>(1,172)</b>	<b>(3)</b>	<b>346</b>
<b>Opening cash</b>	<b>1,277</b>	<b>728</b>	<b>1,867</b>	<b>709</b>	<b>707</b>
<b>Closing cash</b>	<b>728</b>	<b>1,867</b>	<b>709</b>	<b>707</b>	<b>1,053</b>

Source: Company, Fortune Research

## Investment ratings (Returns)

Buy (>10%)	Hold (-10 to 10%)	Sell (<-10%)
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