

## Company

6 August 2010 | 8 pages

# Aurobindo Pharma (ARBN.BO)

 Equity 

## 1Q Miss – Primarily Timing and Mix Driven

- Timing and Mix Hits 1Q** — ARBN's 1Q results missed our expectations, as overheads on its newly commissioned SEZ and adverse revenue mix suppressed margins. However, with shipments from the SEZ having commenced in July, we believe it will be able to make up a large share of this gap over the next three quarters. We believe the turnaround remains on course and would recommend using any share price weakness as an enhanced buying opportunity.
- 1Q Miss** — The 1Q results were weak, with sales growth subdued at 8% YoY, while EBIDTA margins & adjusted PAT declined 433bps & 14% respectively. Lower US sales (currency, delayed shipments from the SEZ) & licensing income kept topline growth subdued. Meanwhile, fresh overheads on its SEZ & a facility in the US (c.Rs150-160m) dragged on margins, as sales from the SEZ started only in July-10.
- Lower Margin Businesses Grow Faster** — After many quarters, APIs (+15%) & ARVs (+7%) were the key topline growth drivers while US formulations (-6%) lagged behind. While the latter is a continuation of the capacity constraint witnessed in 4Q (as SEZ sales started only in July), we are surprised at the former. We believe this may be timing related & will normalize over the year – however, we await further clarity on this front.
- Marked Improvement Ahead** — While disappointed, we believe 1Q is an aberration & expect things to improve materially in the rest of the fiscal (esp. 2H). Shipments from the SEZ have commenced (could contribute c.Rs5bn of incremental revenues in FY11) and should ease capacity constraints on the US & Pfizer businesses. The resultant mix improvement should also aid margin improvement. Besides, the tax benefits will start taking effect from 2HFY11.
- Other Notable Updates** — a) Filed 4 ANDAs and 55 EU dossiers in 1Q; b) 7 ANDAs approved during the quarter; and c) August 2010 FCCBs almost entirely converted (just US\$2.12m worth of bonds outstanding now).

<b>Buy/Medium Risk</b>	<b>1M</b>
Price (05 Aug 10)	Rs943.55
Target price	Rs1,340.00
Expected share price return	42.0%
Expected dividend yield	0.5%
<b>Expected total return</b>	<b>42.5%</b>
Market Cap	Rs54,935M
	US\$1,197M

### Price Performance (RIC: ARBN.BO, BB: ARBP IN)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2008A	1,900	28.10	-5.5	33.6	4.5	18.9	0.3
2009A	2,410	37.28	32.7	25.3	4.1	20.4	0.5
2010E	4,868	75.13	101.5	12.6	2.9	31.7	0.5
2011E	6,554	101.17	34.6	9.3	2.1	29.7	0.5
2012E	8,193	126.46	25.0	7.5	1.5	24.9	0.5

Source: Powered by dataCentral

Prashant Nair, CFA  
 +91-22-6631-9855  
 prashant.nair@citi.com

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Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
<b>Valuation Ratios</b>					
P/E adjusted (x)	33.6	25.3	12.6	9.3	7.5
EV/EBITDA adjusted (x)	20.0	14.3	9.3	7.2	5.6
P/BV (x)	4.5	4.1	2.9	2.1	1.5
Dividend yield (%)	0.3	0.5	0.5	0.5	0.5
<b>Per Share Data (Rs)</b>					
EPS adjusted	28.10	37.28	75.13	101.17	126.46
EPS reported	35.27	15.51	86.96	104.17	126.46
BVPS	209.08	230.89	328.26	442.64	616.95
DPS	3.27	4.50	4.50	4.50	4.50
<b>Profit &amp; Loss (RsM)</b>					
Net sales	24,465	30,773	35,754	44,719	52,170
Operating expenses	-21,952	-26,885	-29,016	-35,838	-41,428
<b>EBIT</b>	<b>2,513</b>	<b>3,888</b>	<b>6,738</b>	<b>8,880</b>	<b>10,742</b>
Net interest expense	-694	-932	-678	-692	-765
Non-operating/exceptionals	1,098	-1,740	1,484	464	137
<b>Pre-tax profit</b>	<b>2,918</b>	<b>1,216</b>	<b>7,544</b>	<b>8,652</b>	<b>10,114</b>
Tax	-536	-214	-1,914	-1,904	-1,922
Extraord./Min.Int./Pref.div.	3	1	3	0	0
<b>Reported net income</b>	<b>2,385</b>	<b>1,003</b>	<b>5,634</b>	<b>6,749</b>	<b>8,193</b>
Adjusted earnings	1,900	2,410	4,868	6,554	8,193
Adjusted EBITDA	3,517	5,164	8,232	10,533	12,552
<b>Growth Rates (%)</b>					
Sales	14.5	25.8	16.2	25.1	16.7
EBIT adjusted	16.5	54.7	73.3	31.8	21.0
EBITDA adjusted	11.5	46.8	59.4	28.0	19.2
EPS adjusted	-5.5	32.7	101.5	34.6	25.0
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>1,587</b>	<b>1,360</b>	<b>4,691</b>	<b>4,014</b>	<b>6,443</b>
Depreciation/amortization	1,004	1,276	1,493	1,653	1,810
Net working capital	-1,272	-3,340	-1,339	-4,110	-3,559
<b>Investing cash flow</b>	<b>-750</b>	<b>-4,063</b>	<b>-4,952</b>	<b>-4,000</b>	<b>-3,000</b>
Capital expenditure	-2,463	-4,830	-4,952	-4,000	-3,000
Acquisitions/disposals	0	0	0	0	0
<b>Financing cash flow</b>	<b>-2,176</b>	<b>1,650</b>	<b>-1,130</b>	<b>-349</b>	<b>-2,682</b>
Borrowings	-1,409	2,867	-837	-42	-2,341
Dividends paid	-157	-393	-293	-307	-341
<b>Change in cash</b>	<b>-1,348</b>	<b>-1,387</b>	<b>-1,391</b>	<b>-335</b>	<b>761</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>36,345</b>	<b>42,265</b>	<b>47,913</b>	<b>55,365</b>	<b>61,992</b>
Cash & cash equivalent	2,826	1,277	728	393	1,154
Accounts receivable	6,650	8,898	9,560	11,639	13,579
Net fixed assets	15,149	19,351	22,809	25,156	26,346
<b>Total liabilities</b>	<b>25,073</b>	<b>29,821</b>	<b>29,579</b>	<b>29,489</b>	<b>21,980</b>
Accounts payable	5,546	5,435	6,728	7,964	9,005
Total Debt	18,470	23,330	21,546	20,125	11,500
<b>Shareholders' funds</b>	<b>11,272</b>	<b>12,444</b>	<b>18,334</b>	<b>25,876</b>	<b>40,012</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	14.4	16.8	23.0	23.6	24.1
ROE adjusted	18.9	20.4	31.7	29.7	24.9
ROIC adjusted	7.6	11.7	12.7	16.0	17.9
Net debt to equity	138.8	177.2	113.5	76.3	25.9
Total debt to capital	62.1	65.2	54.0	43.7	22.3

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# Financial Summary

Figure 1. Aurobindo Pharma – 1QFY11 Financial Summary (RsM, %)

	1QFY10	1QFY11	% Ch YoY	4QFY10	% Ch QoQ	CIRA Comments
Net Sales	8,097	8,837	9.1	9,011	(1.9)	<b>Adjusted PAT lower than expected, primarily on timing and mix issues</b>
Other Operating Income	431	386	(10.4)	237	62.9	
<b>Total Income</b>	<b>8,528</b>	<b>9,223</b>	<b>8.2</b>	<b>9,248</b>	<b>(0.3)</b>	
Material Cost	4,214	4,586	8.8	4,689	(2.2)	Topline driven primarily by lower margin API & ARV sales during the quarter; US sales lag, as sales from SEZ to start a month later (in July) than expected
<i>MC as a % of sales</i>	<i>52.0</i>	<i>51.9</i>	<i>-15bps</i>	<i>52.0</i>	<i>-14bps</i>	
Staff Cost	691	985	42.6	894	10.1	
<i>As a % of sales</i>	<i>8.1</i>	<i>10.7</i>	<i>258bps</i>	<i>9.7</i>	<i>101bps</i>	
Other Expenditure	1,666	1,935	16.1	1,950	(0.8)	Commissioning of the SEZ leads to higher fixed cost, without concomitant increase in revenues – pull down margins
<i>As a % of sales</i>	<i>19.5</i>	<i>21.0</i>	<i>144bps</i>	<i>21.1</i>	<i>-10bps</i>	
Total Expenditure	6,571	7,505	14.2	7,533	(0.4)	
<b>EBITDA</b>	<b>1,957</b>	<b>1,717</b>	<b>(12.2)</b>	<b>1,716</b>	<b>0.1</b>	
<i>EBITDA Margin (%)</i>	<i>22.9</i>	<i>18.6</i>	<i>-433bps</i>	<i>18.6</i>	<i>7bps</i>	
<i>EBITDA Margin (%) - ex dossier income</i>	<i>18.8</i>	<i>15.1</i>	<i>-378bps</i>	<i>16.4</i>	<i>-134bps</i>	
Depreciation/Amortisation	333	401	20.5	388	3.4	Interest cost lower on repayment of higher cost debt
Other Income	22	31	39.5	203	(84.7)	
PBIT	1,647	1,348	(18.2)	1,531	(12.0)	
Interest (net)	227	129	(43.0)	143	(9.4)	Extraordinary items relate primarily to notional MTM losses on FCCBs as the rupee weakened during the quarter v/s the US\$
Extraordinary expense (income) - net	(575)	418	(172.6)	(285)	(246.7)	
PBT	1,995	801	(59.9)	1,673	(52.1)	
Total Tax	331	285	(13.8)	456	(37.5)	
<i>Tax Rate (%)</i>	<i>16.6</i>	<i>35.6</i>	<i>1,902bps</i>	<i>27.3</i>	<i>834bps</i>	
Profit/(Loss) before Minority Interest	1,665	516	(69.0)	1,217	(57.6)	
Minority Interest	(1)	-	(100.0)	(2)	(100.0)	
Reported Net Profit	1,666	516	(69.0)	1,219	(57.7)	
Add: EO exp/(inc) - net of tax	(575)	418	(172.6)	(199)	15.5	
<b>Adj. Net Profit</b>	<b>1,090</b>	<b>933</b>	<b>(14.4)</b>	<b>1,020</b>	<b>(8.5)</b>	

Source: Company Reports and CIRA Estimates

Figure 2. Aurobindo Pharma – 1QFY11 Revenue Breakdown (Rs m, %)

Revenue Break up	1QFY10	1QFY11	% Ch YoY	4QFY10	% Ch QoQ	CIRA Comments
<b>Formulations</b>						
US	2,310	2,162	(6.4)	2,309	(6.4)	Delayed sales from the SEZ, minor currency impact keep US flat Continues momentum seen in 4QFY11
EU	464	744	60.3	855	(13.0)	
RoW	540	550	1.9	660	(16.7)	
ARV	1,375	1,465	6.5	1,357	8.0	
<b>Total Formulations</b>	<b>4,689</b>	<b>4,921</b>	<b>4.9</b>	<b>5,181</b>	<b>(5.0)</b>	
<b>APIs</b>						
SSP	1,517	1,320	(13.0)	1,481	(10.9)	High growth in APIs a surprise – likely to be bunching up of sales – should ease off in subsequent quarters
Cephalosporins	1,390	1,853	33.3	1,850	0.2	
ARV & Others	671	945	40.8	714	32.4	
<b>Total APIs</b>	<b>3,578</b>	<b>4,118</b>	<b>15.1</b>	<b>4,045</b>	<b>1.8</b>	
Dossier Licensing Income	431	386	(10.4)	237	(62.9)	

Source: Company Reports and CIRA Estimates

## Aurobindo Pharma

### Company description

Aurobindo Pharma is an Indian pharma company targeting global generics. It has traditionally had a strong presence in the cephalosporin and ARV segments but has expanded its product basket recently. It is fully integrated and owns one of largest manufacturing bases (14 plants) and portfolios of products amongst Indian companies.

### Investment strategy

We rate Aurobindo Pharma as Buy/Medium Risk (1M), given improving fundamentals and attractive valuations (c.50% disc to the sector). We believe APL is much better placed to leverage its large backend infrastructure and product basket. A multiple-market supply deal with Pfizer and critical scale in its own operations in key markets would drive revenues. Rising capacity utilization and better product mix (higher share of formulations) would drive sustained margin expansion and drive 23% and 30% CAGRs (FY10-12E) in EBIDTA and PAT respectively. Moreover, rising cash generation and lower capex going forward will also enable APL to lower debt and alleviate balance sheet concerns.

### Valuation

We value Aurobindo using a sum of the parts approach. Given that pharma is a growth sector, we use P/E as our primary method to value the base business of pharma companies. We value Aurobindo's core earnings on 14x 12m forward FDEPS - a 30% discount to the target multiple of 20x that we use for sector leaders such as Cipla and DRL. We believe that the discount is justified at this point, given the possibility of equity dilution (to redeem FCCBs in case they do not get converted), risk of an appreciating rupee (c20-25% net exposure) and higher customer concentration (the Pfizer deal). At 14x June '11E EPS we value Aurobindo's core business at Rs1250/sh. We also value Aurobindo's dossier licensing income at 5x. We believe the lower multiple captures the fact that this income stream may not be recurring, at current levels, over the longer term. At 5x June '11 estimates, we value Aurobindo's dossier licensing income at Rs90/sh. Cumulatively, we arrive at our target price of Rs1,340/sh.

### Risks

We rate Aurobindo Medium Risk, in line with our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key downside risks that could impede the stock from reaching our target price include (1) Fresh equity dilution if FCCBs do not get converted; (2) Execution hiccups in the supply deal with Pfizer; (3) Currency Risk - an appreciating INR would be structurally negative.

# Appendix A-1

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#### Fundamental Research

Analyst: Prashant Nair, CFA

Covered since January 19 2010

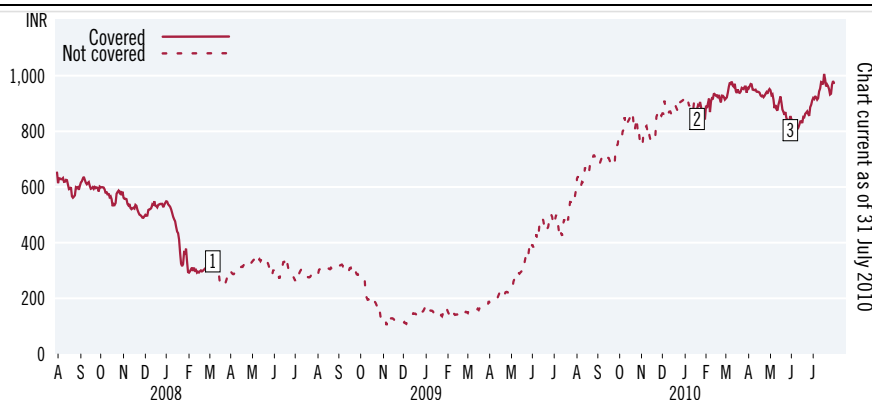


Chart current as of 31 July 2010

	Date	Rating	Target Price	Closing Price
1	6-Mar-08	Coverage suspended		

	Date	Rating	Target Price	Closing Price
2	19-Jan-10	*1M	*1,350.00	879.85

	Date	Rating	Target Price	Closing Price
3	30-May-10	1M	*1,340.00	839.55

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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