

November 9, 2010

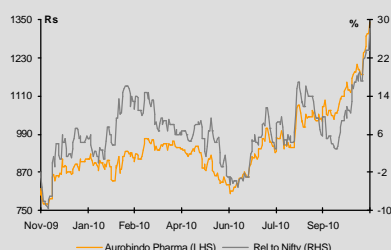
<b>Reco</b>	<b>Previous Reco</b>
Buy	Buy
<b>CMP</b>	<b>Target Price</b>
Rs1343	Rs1581
EPS change FY11E/12E (%)	NA
Target Price change (%)	27
Nifty	6,273
Sensex	20,852

### Price Performance

(%)	1M	3M	6M	12M
Absolute	21	41	50	65
Rel. to Nifty	18	22	24	26

Source: Bloomberg

### Relative Price Chart



Source: Bloomberg

### Stock Details

Sector	Pharmaceuticals
Bloomberg	ARBP@IN
Equity Capital (Rs mn)	291
Face Value(Rs)	5
No of shares o/s (mn)	58
52 Week H/L	1,349/761
Market Cap (Rs bn/USD mn)	78/1,757
Daily Avg Volume (No of sh)	285554
Daily Avg Turnover (US\$mn)	6.9

### Shareholding Pattern (%)

	S'10	J'10	M'10
Promoters	54.4	56.2	56.9
FII/NRI	26.8	23.0	24.2
Institutions	9.3	11.7	10.2
Private Corp	3.4	2.1	2.0
Public	6.1	7.0	6.7

Source: Capitaline

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- **Aurobindo's Q2FY11 performance was above estimates with a) Revenues at Rs10.4bn (up 24%), b) EBITDA at Rs2.5bn (up 23%), and c) APAT at Rs1.22bn (up 14%)**
- **Strong revenue growth was driven by 38% growth in formulation business, higher dossier income (Rs699mn vs. Rs400mn) and ramp-up in SEZ facility (full impact in Q3FY11)**
- **APAT (excl forex gain of Rs762mn), was up 14% to Rs1.22bn**
- **On account of strong performance, raise target price to Rs1,581 (earlier Rs1,242); Maintain Buy**

### All round growth in formulations and dossier income drive the top line growth

Aurobindo's Q2FY11 results were above our expectations. While net revenues grew 24% YoY to Rs10.4bn, profit was up 92% to Rs2bn (including forex gain of Rs762mn). Top line growth was driven by 38% growth in formulations led by a) US (up 29% to Rs3bn), due to commencement of operations at SEZ, b) Europe (up 55% to Rs860mn), c) ARV formulations (up 49% to Rs1.7bn), and d) RoW markets (up 40% to Rs625mn). The excellent growth across regions was on account of unlocking of capacity constraint, with SEZ Unit III commencing its operations. Dossier income (includes licensing income from AstraZeneca) at Rs699mn was higher than expected. Income from dossiers posted good growth of 74% to Rs699mn and contributed 6% to the overall sales. EBITDA for the quarter was up by 23% to Rs2.5bn largely driven by robust top line growth of 26% (including dossier income). This was in spite of contraction in gross margins by 208bps and 27% YoY increase in total expenditures. Adjusted PAT growth of 14% to Rs1.22bn was lower than growth in EBITDA due to a) lower other income (down 17%), b) higher interest outgo (includes Rs35mn YTM paid on redemption of Aug'10 FCCBs), and c) higher tax provisioning (539bps YoY increase). This quarter, the company booked forex gains to the tune of Rs762mn (Rs210mn on account of restatement of FCCBs and Rs552mn of operational gains).

### Revenue break-up

	Rs mn						
	Q2FY10	Q2FY11	YoY (%)	QoQ (%)	YTD'11	YTD'10	YoY (%)
USA	2294	2955	29	37	5117	4604	11
Europe	556	860	55	16	1604	1020	57
ARV	1156	1717	49	17	3182	2531	26
RoW	446	625	40	14	1175	986	19
<b>Total Formulations...A</b>	<b>4452</b>	<b>6157</b>	<b>38</b>	<b>25</b>	<b>11078</b>	<b>9141</b>	<b>21</b>
SSP's	1707	1602	-6	21	2922	3224	-9
Cephs	1653	2062	25	11	3915	3043	29
ARVs	864	853	-1	-10	1798	1535	17
<b>Total APIs...B</b>	<b>4224</b>	<b>4517</b>	<b>7</b>	<b>10</b>	<b>8635</b>	<b>7802</b>	<b>11</b>
<b>Dossier Income...C</b>	<b>402</b>	<b>699</b>	<b>74</b>	<b>81</b>	<b>1085</b>	<b>833</b>	<b>30</b>
<b>Gross Sales...A+B+C</b>	<b>9078</b>	<b>11373</b>	<b>25</b>	<b>21</b>	<b>20798</b>	<b>17776</b>	<b>17</b>

### Financials

	Rs mn									
YE-	Net	EBITDA	EPS	EPS	RoE		EV/			
Mar	Sales	(Core)	(%)	APAT	(Rs)	% chg	(%)	P/E	EBITDA	P/BV
FY09	30,773	3,750	12.8	3,503	65.1	108.8	29.6	20.6	25.1	5.8
FY10	35,754	6,255	18.5	4,533	78.2	20.1	29.7	17.2	15.3	4.3
FY11E	41,204	7,623	19.2	5,443	93.3	19.3	25.4	14.4	12.6	3.2
FY12E	48,975	9,614	20.3	6,587	112.9	21.0	25.0	11.9	9.9	2.8

## Key Financials – Quarterly

Rs mn

Rs mn	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11	YoY (%)	QoQ (%)	YTD'11	YTD'10	YoY (%)
<b>Revenue</b>	<b>8,424</b>	<b>8,246</b>	<b>9,010</b>	<b>8,837</b>	<b>10,427</b>	<b>23.8</b>	<b>18.0</b>	<b>19,264</b>	<b>16,521</b>	<b>16.6</b>
Dossier/other op income	402	907	237	386	699	73.9	81.1	1,085	833	30.3
<b>Total Income</b>	<b>8,826</b>	<b>9,153</b>	<b>9,247</b>	<b>9,223</b>	<b>11,126</b>	<b>26.1</b>	<b>20.6</b>	<b>20,349</b>	<b>17,354</b>	<b>17.3</b>
<b>Expenditure</b>	<b>6,756</b>	<b>6,664</b>	<b>7,532</b>	<b>7,505</b>	<b>8,584</b>	<b>27.0</b>	<b>14.4</b>	<b>16,089</b>	<b>13,327</b>	<b>20.7</b>
<i>as % of sales</i>	<i>80.2</i>	<i>80.8</i>	<i>83.6</i>	<i>84.9</i>	<i>82.3</i>	212bps	-261bps	<i>83.5</i>	<i>80.7</i>	
Consumption of RM	4,217	4,092	4,688	4,586	5,548	31.5	21.0	10,133	8,431	20.2
<i>as % of sales</i>	<i>50.1</i>	<i>49.6</i>	<i>52.0</i>	<i>51.9</i>	<i>53.2</i>	314bps	131bps	<i>52.6</i>	<i>51.0</i>	
Employee Cost	787	901	895	985	1,074	36.5	9.0	2,059	1,477	39.4
<i>as % of sales</i>	<i>9.3</i>	<i>10.9</i>	<i>9.9</i>	<i>11.1</i>	<i>10.3</i>	96bps	-85bps	<i>10.7</i>	<i>8.9</i>	
Other expenditure	1,753	1,671	1,949	1,935	1,963	12.0	1.4	3,898	3,419	14.0
<i>as % of sales</i>	<i>20.8</i>	<i>20.3</i>	<i>21.6</i>	<i>21.9</i>	<i>18.8</i>	-198bps	-307bps	<i>20.2</i>	<i>20.7</i>	
<b>EBITDA</b>	<b>2,070</b>	<b>2,489</b>	<b>1,716</b>	<b>1,717</b>	<b>2,542</b>	<b>22.8</b>	<b>48.0</b>	<b>4,260</b>	<b>4,027</b>	<b>5.8</b>
Depreciation	370	404	387	401	407	10.1	1.6	808	702	15.0
<b>EBIT</b>	<b>1,700</b>	<b>2,085</b>	<b>1,328</b>	<b>1,317</b>	<b>2,135</b>	<b>25.6</b>	<b>62.2</b>	<b>3,452</b>	<b>3,325</b>	<b>3.8</b>
Other Income	127	37	200	31	106	(16.7)	240.2	137	149	(8.3)
Interest	182	127	142	129	193	5.9	49.1	322	409	(21.2)
<b>PBT</b>	<b>1,646</b>	<b>1,995</b>	<b>1,386</b>	<b>1,219</b>	<b>2,048</b>	<b>24.5</b>	<b>68.1</b>	<b>3,267</b>	<b>3,065</b>	<b>6.6</b>
Total Tax	578	549	456	285	830	43.6	191.0	1,115	909	22.7
<b>Adjusted PAT</b>	<b>1,068</b>	<b>1,446</b>	<b>930</b>	<b>933</b>	<b>1,219</b>	<b>14.1</b>	<b>30.5</b>	<b>2,152</b>	<b>2,157</b>	<b>(0.2)</b>
(Profit)/loss from JV's/Ass/MI	0.2	22	-2.3	0.7	-2.8	-	-	-2.1	-1	
<b>APAT after MI</b>	<b>1,068</b>	<b>1,468</b>	<b>932</b>	<b>933</b>	<b>1,221</b>	<b>14.4</b>	<b>30.9</b>	<b>2,154</b>	<b>2,158</b>	<b>(0.2)</b>
EO/ forex (gain)/loss	36	-248	-285	418	-762	-	-	-344	-540	(36.2)
<b>Reported PAT</b>	<b>1,032</b>	<b>1,716</b>	<b>1,217</b>	<b>515</b>	<b>1,983</b>	<b>92.2</b>	<b>285.1</b>	<b>2,498</b>	<b>2,698</b>	<b>(7.4)</b>
<b>AEPS</b>	<b>19.9</b>	<b>27.3</b>	<b>16.0</b>	<b>16.0</b>	<b>21.0</b>	<b>5.7</b>	<b>31.1</b>	<b>37.0</b>	<b>38.6</b>	<b>(4.1)</b>

Margins (%)						(bps)	(bps)			(bps)
EBIDTA	23.5	27.2	18.6	18.6	22.8	(60)	423	20.9	23.2	(227)
EBITDA (Excl. dossiers/OOI)	19.8	19.2	16.4	15.1	17.7	(212)	261	16.5	19.3	(285)
EBIT	19.3	22.8	14.4	14.3	19.2	(8)	491	17.0	19.2	(220)
EBT	18.6	21.8	15.0	13.2	18.4	(23)	520	16.1	17.7	(161)
PAT	12.1	16.0	10.1	10.1	11.0	(112)	86	10.6	12.4	(185)
Effective Tax rate	35.1	27.5	32.9	23.4	40.5	539	1711	34.1	29.6	449

### **High fixed overheads impacted operating performance**

Operating margins for the quarter declined by 60bps to 22.8% mainly because of increase in fixed overheads from the unit at SEZ and New Jersey. However, commencement of operations of SEZ unit led to 423bps QoQ expansion in EBITDA margins. Higher employee cost (up 36% YoY) was on account of annual increments and festival bonuses this quarter. Adjusting for one-offs (such as the increment and bonus), EBITDA margins would have witnessed YoY expansion of 200bps.

### **APAT at Rs1.22bn is above our expectation**

Despite lower other income (down 17%) and higher tax provisioning (up 539bps YoY), APAT was above our expectations at Rs1.22bn (we expected Rs1.1bn). Higher interest cost was due to non-recurring amount of Rs35mn paid on redemption of Aug2010 FCCB. The company has incurred forex gain of Rs762mn vs. forex loss of Rs36mn in Q2FY11. Out of this, Rs210mn is MTM gains and Rs552mn is from operations. Adjusted EPS stood at Rs21 for the quarter and Rs37 for H1FY11 (reported EPS of Rs50). Going ahead, we believe net profit to grow at 21% CAGR to Rs6.6bn over FY10-12E, clocking an EPS of Rs113 in FY12E.

### **H2FY11 likely to be stronger than H1FY11**

We believe H2FY11 will be robust than H1FY11 on account of a) first full quarter impact of operations at its Hyderabad SEZ facility, and b) higher revenue contribution from supply agreements with Pfizer and other innovators (product ramp-up from the Pfizer contract has already commenced). The SEZ facility has the capacity to manufacture 6bn tablets per annum (can be increased up to 18bn tablets with minimum incremental capex). We expect the capacity utilization to increase to 45-50% by the end of FY11E from the current levels of 30%. Increased product ramp-up from the Pfizer deal will further lead the utilization levels to increase by FY12. Further savings in tax will lead to incremental earnings. With operating and financial leverage coming into play, we believe that Aurobindo is now in a much better position to leverage its extensive manufacturing infrastructure, going forward.

### **Revise target price upwards to Rs1581; Re-iterate Buy**

During H1FY11, the company has clocked adjusted EPS of Rs37 (reported EPS of Rs50.1) against our full estimation of Rs93.3 in FY11E. We continue to maintain our earning estimates of Rs93.3 and Rs112.9 for FY11E and FY12E respectively. We believe that this quarter performance is encouraging and expect the company to improve its earnings trajectory from next quarter onwards on account of incremental contribution from the Pfizer deal and commencement of operations at Unit III (Hyderabad SEZ). We are of the view that Aurobindo provides good visibility in terms of consistent CAGR growth of 19% over next few years. We raise our target price on the stock to Rs1581 (Rs 1,242 earlier), valuing at 14x adjusted FY12E EPS. At CMP, the stock trades at 14.4x FY11E and 11.9x FY12E EPS. Re-iterate Buy.

## Financials

## Income Statement

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
<b>Net Sales</b>	<b>29,349</b>	<b>33,777</b>	<b>39,704</b>	<b>47,475</b>
Growth (%)	20.5	15.1	17.5	19.6
<b>Dossier Income</b>	<b>1424</b>	<b>1977</b>	<b>1500</b>	<b>1500</b>
<b>Total Sales</b>	<b>30,773</b>	<b>35,754</b>	<b>41,204</b>	<b>48,975</b>
<b>Expenditure</b>	<b>25,599</b>	<b>27,523</b>	<b>32,081</b>	<b>37,861</b>
Raw Materials	16,367	17,211	19,852	23,500
R&D	1,032	1,015	1,787	2,136
Employee Cost	2,437	3,273	4,050	4,747
Other Exp	5,763	6,024	6,392	7,477
<b>EBITDA (excl. dossier income)</b>	<b>3,750</b>	<b>6,255</b>	<b>7,623</b>	<b>9,614</b>
Growth (%)	9.9	66.8	21.9	26.1
<b>EBITDA (incl. dossier income)</b>	<b>5,174</b>	<b>8,232</b>	<b>9,123</b>	<b>11,114</b>
Growth (%)	47	59	11	22
<b>OPM % (excl. dossier income)</b>	<b>12.8</b>	<b>18.5</b>	<b>19.2</b>	<b>20.3</b>
<b>EOPM % (incl. dossier income)</b>	<b>16.8</b>	<b>23.0</b>	<b>22.1</b>	<b>22.7</b>
Depreciation	1,276	1,493	1,725	1,986
<b>EBIT</b>	<b>3,898</b>	<b>6,738</b>	<b>7,398</b>	<b>9,128</b>
<b>EBIT margin (%)</b>	<b>13.3</b>	<b>19.9</b>	<b>18.6</b>	<b>19.2</b>
Other Income	167	389	389	389
Interest expenses	839	678	809	1,179
<b>PBT</b>	<b>726</b>	<b>7,522</b>	<b>6,978</b>	<b>5,436</b>
Tax	214	1,914	1,535	1,141
Effective tax rate (%)	29.4	25.4	22.0	21.0
<b>Adjusted PAT</b>	<b>3,993</b>	<b>4,558</b>	<b>5,443</b>	<b>6,587</b>
(Profit)/loss from JV's/Ass/MI	490	25	0	0
<b>Adjusted PAT after MI</b>	<b>3,503</b>	<b>4,533</b>	<b>5,443</b>	<b>6,587</b>
Growth (%)	108.8	29.4	20.1	21.0
<b>Adj. Net Margin (%)</b>	<b>11.4</b>	<b>12.7</b>	<b>13.2</b>	<b>13.4</b>
Forex (gain)/loss, extraordinary item	2,990	-1,051	0	2,293
<b>Reported PAT</b>	<b>513</b>	<b>5,609</b>	<b>5,443</b>	<b>4,294</b>

## Cash Flow

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
<b>PBT (Ex-Other income)</b>	<b>-865</b>	<b>5,156</b>	<b>5,088</b>	<b>3,546</b>
Depreciation	1,276	1,493	1,725	1,986
Interest Provided	839	678	809	1,179
Other Non-Cash items	-167	-938	-1,084	-1,155
Chg in working cap	-3,406	-1,339	-1,535	-3,374
Tax paid	-214	-1,914	-1,535	-1,141
<b>Operating Cashflow</b>	<b>-2,537</b>	<b>3,137</b>	<b>3,470</b>	<b>1,040</b>
Capital expenditure	-5,478	-5,001	-3,000	-2,200
<b>Free Cash Flow</b>	<b>-8,015</b>	<b>-1,864</b>	<b>470</b>	<b>-1,160</b>
Other income	1,591	2,366	1,889	1,889
Investments	602	0	0	0
<b>Investing Cashflow</b>	<b>-3,285</b>	<b>-2,635</b>	<b>-1,110</b>	<b>-311</b>
Equity Capital Raised	581	1,094	1,358	374
Loans Taken / (Repaid)	4,246	-1,787	738	-578
Interest Paid	-839	-678	-809	-1,179
Dividend paid (incl tax)	283	324	391	391
<b>Financing Cashflow</b>	<b>4,272</b>	<b>-1,046</b>	<b>1,677</b>	<b>-992</b>
<b>Net chg in cash</b>	<b>-1,551</b>	<b>-544</b>	<b>4,036</b>	<b>-262</b>
Opening cash position	2,810	1,259	715	4,751
Closing cash position	1,259	715	4,751	4,489

## Balance Sheet

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
Equity share capital	269	279	292	292
Reserves & surplus	12,130	18,012	24,150	28,053
<b>Net worth</b>	<b>12,398</b>	<b>18,291</b>	<b>24,442</b>	<b>28,345</b>
<b>Minority Interest</b>	<b>32</b>	<b>43</b>	<b>0</b>	<b>0</b>
Secured Loans	9,877	8,641	9,990	17,089
Unsecured Loans	13,453	12,902	12,291	4,614
<b>Loan Funds</b>	<b>23,330</b>	<b>21,543</b>	<b>22,281</b>	<b>21,703</b>
Net deferred tax liability	769	954	954	954
<b>Total Liabilities</b>	<b>36,528</b>	<b>40,831</b>	<b>47,676</b>	<b>51,001</b>
Gross Block	19,736	24,077	27,077	29,277
Less: Depreciation	5,749	7,242	8,967	10,953
<b>Net block</b>	<b>13,988</b>	<b>16,835</b>	<b>18,109</b>	<b>18,323</b>
Capital work in progress	5,363	6,024	6,024	6,024
<b>Investment</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>
<b>Current Assets</b>	<b>22,875</b>	<b>25,049</b>	<b>31,778</b>	<b>36,501</b>
Inventories	8,776	11,025	12,403	14,525
Sundry debtors	8,898	9,560	10,660	12,747
Cash & bank balance	1,259	715	4,751	4,489
Loans & advances	3,869	3,713	3,970	4,747
Other current assets	73	36	-7	-6
<b>Current lia &amp; Prov</b>	<b>5,701</b>	<b>7,080</b>	<b>8,237</b>	<b>9,850</b>
Current liabilities	5,435	6,728	7,832	9,365
Provisions	266	352	406	485
<b>Net current assets</b>	<b>17,175</b>	<b>17,969</b>	<b>23,540</b>	<b>26,651</b>
Misc. exp & Def. Assets	0	0	0	0
<b>Total Assets</b>	<b>36,528</b>	<b>40,831</b>	<b>47,676</b>	<b>51,001</b>

## Key ratios

Y/E, Mar	FY09	FY10	FY11E	FY12E
<b>Profitability (%)</b>				
Core EBITDA Margin	12.8	18.5	19.2	20.3
Net Margin	11.4	12.8	13.2	13.4
ROCE	12.0	18.4	17.6	19.3
ROE	29.6	29.7	25.4	25.0
RoIC	34.4	38.7	39.8	42.0
<b>Per Share Data (Rs)</b>				
EPS (adjusted)	65.1	78.2	93.3	112.9
CEPS	88.9	103.9	122.9	147.0
BVPS	231.2	314.5	419.1	486.0
DPS	1.5	1.9	5.0	5.0
<b>Valuations (x)</b>				
PER	20.6	17.2	14.4	11.9
P/CEPS	15.1	12.9	10.9	9.1
P/BV	5.8	4.3	3.2	2.8
EV / Sales	3.2	2.8	2.4	2.0
EV / EBITDA	25.1	15.3	12.6	9.9
Dividend Yield (%)	0.1	0.1	0.4	0.4
<b>Turnover (x) Days</b>				
Debtors T/O	111	103	98	98
Inventory T/O	109	119	114	112
<b>Gearing Ratio (x)</b>				
Net Debt/ Equity	1.8	1.1	0.7	0.6
Net Debt/EBIDTA	4.3	2.5	1.9	1.5

**Recommendation History: Aurobindo Pharma – ARBP IN**

Date	Reports	Reco	CMP	Target
17/08/2010	<a href="#">Aurobindo Pharma - Initiating Coverage</a>	Buy	949	1,242
05/10/2010	<a href="#">Aurobindo Pharma Visit Note</a>	Buy	1,066	1,242

**Recent Research Reports**

Date	Reports	Reco	CMP	Target
29/10/2010	<a href="#">GlaxoSmithKline Pharma Q3CY10 Result Update</a>	Hold	2,262	2,020
25/10/2010	<a href="#">Torrent Pharma Q2FY11 Result Update</a>	Buy	558	650
25/10/2010	<a href="#">Dr Reddy's Lab Q2FY11 Result Update</a>	Accumulate	1,616	1,763
25/10/2010	<a href="#">Pirmal Healthcare Q2FY11 Result Update</a>	Hold	515	531

**Emkay Global Financial Services Ltd.**

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