Initiating Coverage

BUY

AUROBINDO PHARMA LTD (APL)

...transforming growth

June 25, 2010

Ratings	BUY
CMP (INR)	862
Price Target (INR)	1334
Return (%)	55
Key Data	
BSE Code	524804
Reuters Code	ARBN.BO
Sensex	17730
No.of Shares,mn (Diluted)	57.8
Face Value	5.0
Mcap,Rs mn	50402
Mcap,USD mn @ 46.50	1083.9
52 week H/L (Rs.)	990 / 406
2W Avg. Qty	25231
Share holding, Mar'10	**% Holding**
Promoters	56.9
FII	23.9
DII	10.2
Others	9.0
Total	100
Holding >1% (Non Promoter)	
HSBC Global Investment Funds	4.3
Life Insurance Corporation of India	2.6
Artha EM Fund Mauritius	2.8
Sundaram BNP Paribas Mutual Fund	1.7
Caam Funds India	1.3
Kotak India Focus Fund	1.2
The India Fund Inc	1.0

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Investment Highlights

EBIDTA margins to get boost

EBIDTA margins, which saddled in the range of 13-17% in FY06-09, are set to improve further on account of higher proportion of formulations, assured off-take from Pfizer and growing supply agreements with MNCs, triggered by dossier filing activities.

To augment capacity utilization

The capacity utilization as on date in case of formulations is still a low of ~15-30%. The company is vertically integrated with 95% of the key intermediates and APIs required for formulations are made in-house. EBIDTA margins will also improve on account of improved capacity utilization.

Monetization of ANDAs in the US to facilitate sustainable cash flows

As on 31st March 2010, the company has filed 169 ANDAs. Out of which it has received 84 final approvals and 29 tentative approvals. We expect the US business to grow by 50% to Rs.18bn between FY09 to FY12 on the back of monetization.

Pfizer Deal

APL entered into a licensing & supply arrangement with Pfizer Inc. to sell over 100 oral and sterile products in various markets including the USA and France, the top 2 markets for Pfizer. This deal has demonstrated company's superior capabilities.

ARV business to become EBIDTA accretive

The ARV business (Anti-Aids), which is entirely tender, based, is up for major reshuffle. The company will be selective in bidding for global tenders and more and more revenue will come from US ANDAs and commercial tenders, which will improve margins.

US Healthcare bill to have positive impact on generic players

Passing of US Healthcare Bill has thrown up huge opportunities for Indian Generic players. With huge product basket, approved facilities and good filing run-rate together with vertically integrated business model, the company is well poised to reap the benefits of the same.

Valuation & Recommendation

The scrip is currently trading at ~5x FY12 EV/EBIDTA, a substantial discount vis-à-vis industry peers because on its legacy API model. But with the kind of transformation, vertically integrated business model, capacity build up in niche segments plus deals with the MNCs as the one with Pfizer, we believe the scrip has the potential for re-rating. **We have ascertained a target of Rs. 1334, based on 7x FY12 EV/EBIDTA for 12-15 months investment horizon.**

Exibit-1: Financial Snapshot Rsm

YE Mar.	Revenues	Growth	EBIDTA	EBIDTA	Adj NP	Growth	Adj EPS Rs.	P.E x	EV / EBITDA x	EV/Sales x	ROCE
FY08A	24465.9	*15%*	3518.1	14%	2385.9	*19%*	44.4	19.4	18.8	2.7	8%
FY09A	30773.1	*26%*	5164.6	17%	2405.0	*1%*	44.7	19.3	13.9	2.3	19%
FY10A	35754.0	*16%*	8231.5	23%	4817.6	*100%*	86.4	10.0	8.6	2.0	17%
FY11F	41984.8	*17%*	9960.8	24%	5451.6	*13%*	94.3	9.1	6.7	1.6	16%
FY12F	50320.2	*20%*	12695.2	25%	7734.4	*42%*	133.8	6.4	4.9	1.2	24%

Source: Company & Sunidhi Research

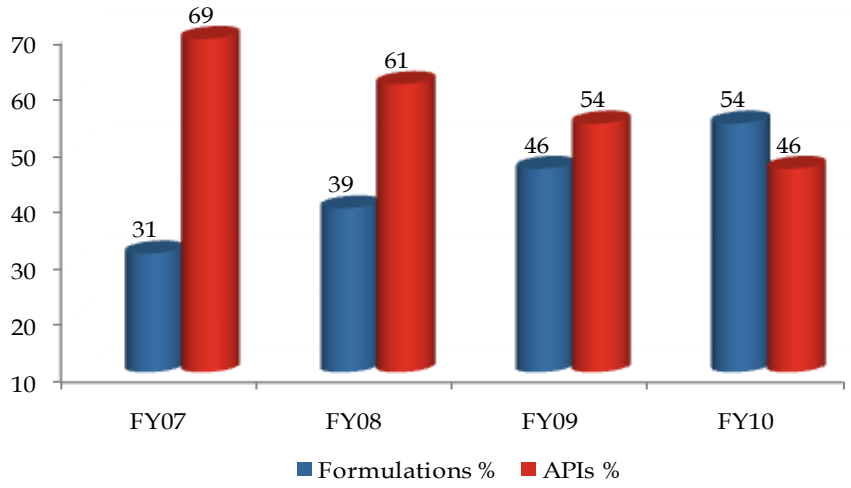
Investment Rationale

Change in Revenue Mix in favour of formulations to improve Margins.

Formulations to constitute ~66% and ~ 73% of base business in FY11 and FY12

The company was predominantly an API supplier with close to 70% of the sales coming from APIs in FY07. Since then it has consciously moved up the value chain by expanding into formulations and for FY10 formulations to API ratio for the base business stood at 54:46 (Exhibit 2). Going forward, we believe formulations will constitute more than 70-75% of the base sales and maximum APIs will be used for conversion into high margin formulations. The company in recent years has ramped up global filing activities and it has positioned itself as one of the largest generics suppliers from India.

Exibit-2: API: formulation ratio – FY07-FY10



Source: Company & Sunidhi Research

The shift towards formulations will also improve EBIDTA margins; in fact the results are already visible. Margins have improved by ~ 700 bps to 23% during FY07-10. Although it is true that margins got boost from higher Dossier sales, we believe that the main growth will only come from this paradigm shift as the Dossier income is expected to be more or less constant in the coming years. We expect margins to remain in the range of 23-25% for FY10-FY12.

To expand into niche formulations

APL's formulation facilities have been backed by its own API facilities. The business model is vertically integrated with ~95% of the key intermediates and APIs required for formulations are made in-house. This has facilitated the company to enter into other niche segments such as Cardiovascular (CVS), Central Nervous System (CNS) and Gastroenterologicals (GI), other than its traditional segments of Antibiotics and ARVs. Having said this, we also observe that the company will remain committed to Antibiotics, the single largest therapeutic group globally, especially high-end ones such as Cephalosporins (3rd & 4th generation) and Penams. Also in ARVs the company will be selective in tender selection (discussed latter).

Aurobindo has added two more formulations facilities (one acquired facility and one SEZ) in FY10. The SEZ unit VII has already gone on stream. The Trident facility (acquired for about Rs.2bn) is expected to start commercial production in FY12. Aurobindo expects some Rs.1bn of business a year from this facility in couple of years. The plant is expected to manufacture general injectable range of formulation products.

Overall the company has invested nearly Rs.10bn. in the last five years to build up the formulations capacities.

Incremental APIs will be used for captive purpose

Domestic sales are predominantly API Sales. The company is a leading player in APIs and has a strong presence in Antibiotics such as Semi-Synthetic Penicillins (SSPs) and Cephalosporins (Cephs). It ranks the highest in terms of DMF filings by any Indian company and is the second largest globally. The company has filed a total of 1557 DMF filings globally of which 145 pertain to the US market 1036 in EU and 295 in ROW.

Since more and more APIs will be used for formulations, we see the share of APIs to net sales to go down to ~27-30% by FY12.

To augment large un-used Formulation Capacity Utilization

Better capacity utilization to improve EBIDTA margins

Aurobindo currently owns 16 manufacturing facilities- 14 are in India and one each in US and China. The recently acquired Trident facility and SEZ unit VII are yet to start commercial production. Overall capacity utilization in case of most of the formulation plants is still bellow 30%. The augmented capacity utilization will strengthen the EBIDTA margins as shown in the common-size statement.

Exibit-3: Common size statement

%	FY09	FY10	FY11	FY12
Total Sales	**100.0**	**100.0**	**100.0**	**100.0**
Raw Materials (incl. Stk adj)	53.2	48.1	48.1	48.0
Staff Cost	7.9	9.2	9.4	9.4
Other expenditure	22.1	19.7	18.8	17.4
Total Expenditure	**83.2**	**77.0**	**76.3**	**74.8**
EBITDA	**16.8**	**23.0**	**23.7**	**25.2**

Source: Company & Sunidhi Research

New Facility addition and additional Capex

APL will add three more formulations facilities

Entire planed capex will be for formulations

- New multipurpose liquid injectable facility near Hyderabad, specializing in manufacture of general injectable range including glass vials for lyophilized sterile powder and liquids and ampoules
- High end antibiotic Penams powder injectable facility near New Delhi and
- Oral Contraceptive facility near Hyderabad. The additional three facilities are expected to go on-stream by FY12-13; this will further boost the formulations basket.

It intends to spend additional Rs.3-3.25bn on capex in FY11 on the following activities

Exibit-4: Capex

Activity	Amt (Rsbn)
Maintenance Capex	1.0
CRAMS	0.8
Upgradation of US facility	0.7
Facility for Oral Contraceptives	0.5
High end Antibiotic Penam injectibles	0.4
Total	**3.3**

Source: Company & Sunidhi Research

Foray into CRAMS through new division 'Aurosource'

CRAMS business to start revenue generation post FY12

In March Aurobindo launched AuroSource, its new division for providing custom research and manufacturing services (Crams). The company intends to cash on the next up-cycle in the Crams space after almost 12-18 months of subdued activities across the globe. The dedicated Crams facility will act as a separate division with dedicated workforce catering to Chemicals and formulation Research.

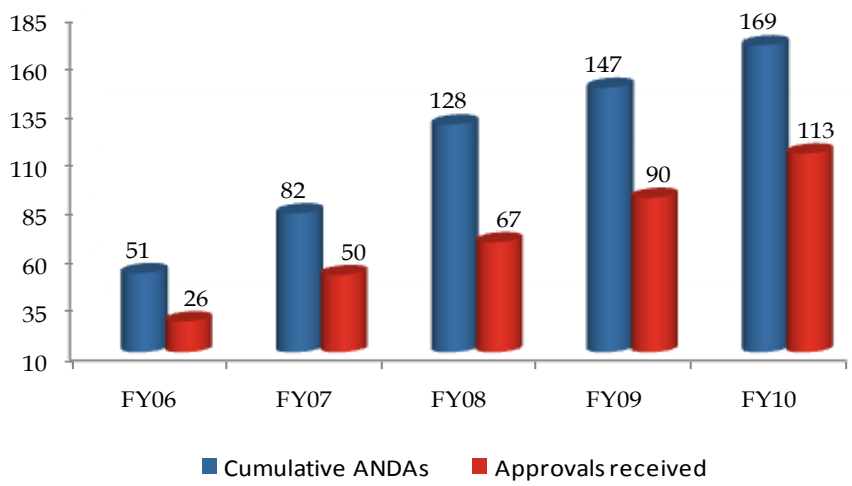
Monetization of ANDAs in the US

Tie-ups with major US distributors for generics sales

Aurobindo was relatively late entrant in the $350bn US market. Company's strategy in the US market is- 1) to get a hold on huge Generic opportunities that would be available in this post patent /drying pipeline era, 2) to exploit and optimize the commercial value of products on hand and 3) to fast track the launch of products and increase the product pipeline. The company has already established strong relationships with marketing and distribution channels in the US such as McKesson, Amerisource, Kaiser, Cardinal Health, Walgreen, Wall mart etc.

As on 31st March 2010 the company has filed as many as 169 ANDAs and has already received approvals for 113 (83 final + 30 tentative). Out of these filings, at least 60 are para IV filings. The company has also filed 145 DMFs cumulatively for APIs.

Exibit-5: ANDA filing



Source: Company & Sunidhi Research

Aggressive filing of ANDA in the US

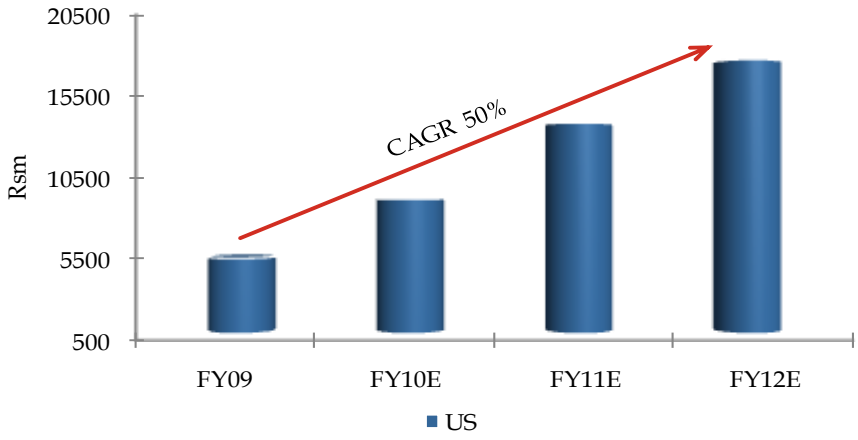
So far the company has launched more than 90% of products (out of 83 final approvals) in categories such as Antibiotcs, Cardiovascular (CVS) Central Nervous System (CNS), Antiretrovirals (ARVs), and Anti-Diabetic. It intends to file another 125 ANDAs in the next 2-3 years, which will include more than 60 para IVs.

In July 2006, Aurobindo acquired a US-based FDA compliant cGMP facility for Oral dosages in the state of New Jersey from a multinational major for $19Mn. This facility is been used for manufacturing as well as product distribution.

We expect the US business to grow by 50% to Rs.18bn between FY09 to FY12E on the back of monetization of huge ANDA pipeline and the Pfizer deal (which we will discuss separately). The contribution from US Sales to the base business is also expected to grow from 18% to 37% between FY09-FY12. By

FY12 we expect US business to be the single largest contributor to the base business.

Exibit-6: US Business



Source: Company & Sunidhi Research

Pfizer Deal

In May 2009, the company entered into a licensing and supply agreement with Pfizer Inc. to sell over 100 products in the US, 30 countries in EU including France, Canada, Australia-New-Zealand and almost 110 ROW countries. The deal covers exclusive, non-exclusive as well as co-exclusive agreements for various products.

Alliance with Pfizer-a win-win deal

Pfizer is under pressure as several of its blockbuster drugs covering 40% of its revenue will go off-patent in the next couple of years. Notable examples are- Lipitor- Size ($11bn), Lyrica- Size ($2.8bn), Effexor- Size ($2.8bn) and Zosyn- Size ($1.2bn) Pfizer is now contemplating three-pronged strategy to expand its portfolio- 1) to partner with other companies and in-license their products, 2) getting some of its products manufactured at cost-effective rates at FDA approved facilities in other countries, and 3) To acquire companies with proven capabilities.

Pfizer also has got its task cut out after a $68bn acquisition of Wyeth, which was partly funded by $24bn unsecured notes. The company has already cut its CY12 revenue guidance by $800mn on account of US Healthcare legislation which is tilted towards generics. The only way to maintain the profitability will be cost rationalization which will be achieved through alliances and partnerships. Pfizer management has chalked out a strategy to cut operating costs by at least $ 4-5bn by CY12. Pfizer is getting ready for the off-patent regime. If it does not ally with the generic players, it would be under pressure from the same players in the generic market. So the company is actually putting in place a de-risking model.

Pfizer is strengthening established product unit for off-patented products

With the alliances like Aurobindo, Pfizer is trying to boost its Established Drugs Unit. This unit is part of its generics subsidiary Greenstone, which currently has 300 products in its basket, including former blockbusters such as Zoloft for depression, Norvasc for high blood pressure, Zithromax for bacterial infections and Medrol for inflammatory and immune conditions, such as asthma, arthritis and lupus. Pfizer envisages this unit to be a major growth driver by 2011. In Q1CY10, this unit contributed ~17% to Pfizer's overall sales of $14.50bn. According to Pfizer, the global Established drugs market which was $270bn in CY2006 is expected to grow to at least $500bn by

CY2011. Globally Pfizer has just ~5% share in the Established drugs market and it wants to improve on this number.

The alliances will also help Pfizer to boost its Emerging markets Unit, which focuses on rest of the world markets covering emerging economies of Latin America, Eastern Europe and Asia (ex Japan) where demographic improvement is facilitating need for quality healthcare. Pfizer expects this market to go up to $250Bn by CY2011, from $125Bn in CY 2008. The share of this unit was ~12% of pfizer's overall revenue for Q1CY10.

Although the company does not share Pfizer numbers separately, Reports from the media suggests that Pfizer deal has racked ~$50mn during FY10. We expect Pfizer sales to grow almost 5 fold to ~$270-280 by FY12, which is equivalent to Rs.13bn. The huge ramp-up will be in sync with Pfizer's target of ~$4-5bn worth of cost savings globally, by CY12.

EU and ROW businesses shaping up

EU & ROW formulation business to constitute 24% of base sales by FY12 from 13% at present

Currently European formulation business constitutes 7% of the base sales. To centralize the European operations the company has created a hub at Malta to cater to different European customers. This hub will operate as centralized quality control warehouse to take care of packaging and logistical activities. As of on 31st March 2010 the company has filled 764 dossiers (including multiple registrations) cumulatively and received approvals for 290 Dossiers. Similarly the company has filled as many as 1036 DMFs cumulatively for APIs in the EU.

In February 2006, the company acquired UK based Milpharm Ltd, the generic formulation pharmaceutical company engaged in selling generic formulations, mainly in the UK market. Milpharm Ltd., is a generic formulation company, owns over 100 approved Marketing Authorizations (MAs) by Medicines and Healthcare Products Regulatory Agency, UK (UK MHRA). The MAs are well diversified into various segments – CNS, CVS, GI, Anti fungal, Anti bacterial, Oncology, Cephs and SSPs, anti diabetic, NSAIDS etc.

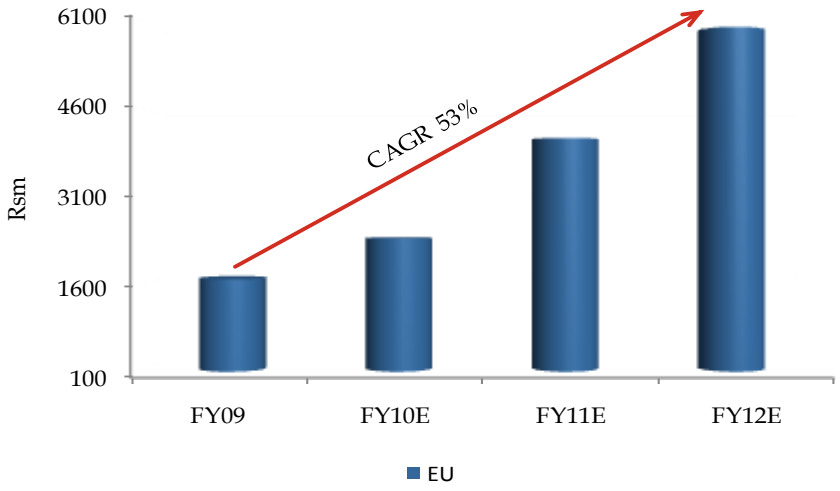
In December 2006, it made another acquisition in Europe, of a Dutch company Pharmacin International BV. Pharmacin engaged in the business of supply and licensing of generic pharmaceuticals in the Netherlands and in select key markets in Europe. Pharmacin owns several product dossiers/market authorizations and IPRs. Pharmacin has a broad product portfolio in three key segments – CNS, CVS and Gastroenterological and the dossiers support over 200 product registrations for 63 customers in Netherlands and Europe.

Acquisition and Dossier fillings to drive EU growth

In March 2008, it acquired 3rd company in EU, by taking over the Italian operations of German pharmaceutical major TAD Pharmaceuticals. The acquisition has given Aurobindo access to more than 70 ready-to-market products, which will speed up its entry into the Italian generic market, while reducing the time to market and enhance the relationships in the generic value chain in addition to building a broad and formidable product portfolio. At ~ €10Mn, the acquisition was in line with the other two acquisitions.

We expect Europe to grow to Rs.6bn, a CAGR of ~53% between FY09-12, boosted by 1) acquired businesses, 2) focus on new markets such as Germany, Portulgal, Spain and erstwhile Yugoslav countries and 3) Supply agreements with MNCs including Pfizer across the region . The traction will also come from scaling up of company's own product portfolio as it intends to leverage upon the marketing network from its three acquisitions.

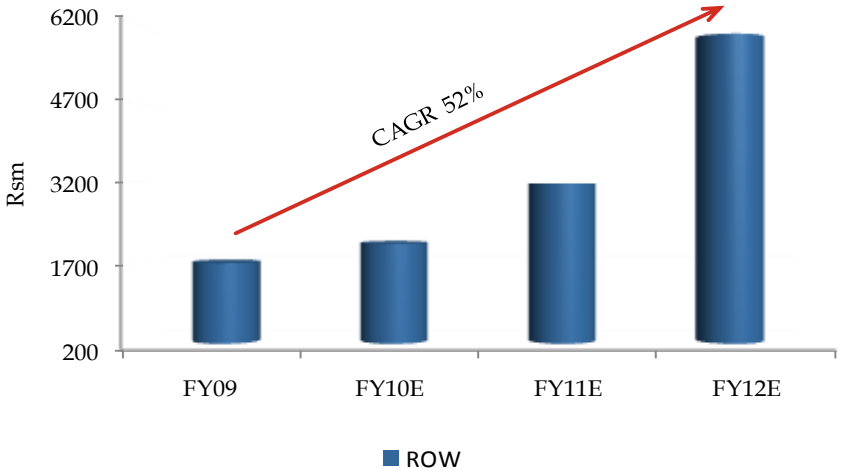
Exibit-7: EU Business



Source: Company & Sunidhi Research

Similarly the ROW business, which currently forms 7% of base business, will get boost from Pfizer deal and aggressive regulatory filings. As on 31st March the company has filed 295 DMFs in various countries. We expect ROW business to grow at a CAGR of 52% between FY09-12

Exibit-8: ROW Business



Source: Company & Sunidhi Research

The ARV segment is tender based

Although it is growing at a steady pace, the margins in most of the tenders are low. The company follows extensive participation in all global tenders. The tenders are for specific programs such as President's Emergency Plan For AIDS Relief (PEPFAR/Emergency Plan) Clinton Foundation, etc and country specific tenders.

Will remain selective in choosing gobal ARV tenders

Going forward we see the company to follow a measured path for growth by selectively participating in the global government tenders and increasingly filing of ANDAs for the US market. We don't see a total de-focus happening in this vertical, given that the US government has spent nearly $19Bn between 2004 and 2008 for PEPFAR and has committed another $6Bn in 2010 for AIDS program. With nearly 33Mn people living with HIV/AIDS, this business will remain a steady cash generator for the company in the coming years. ARV

forms the largest block of ANDA approvals received for the US market and majority of the approvals are for the above–mentioned programmes.

This vertical is slated to grow steadily at ~5-10% pa to Rs.5.67bn by FY12.

Consolidated Debt as on 31st March2010 at Rs.21.55bn

The break-up is as follows- Secured Loan Rs.0.7bn, Working Capital Finance and Unsecured Loans- Rs.12.15bn, Sales Tax Deferment Rs.1bn and FCCBs Rs.7.7bn (~$171mn).

Following table gives the details of the FCCBs

Exibit-9: FCCBs

FCCB	Conversion Price (Rs.)	O/S As on 31st Mar 10	Redemption Date	Fx Rate per USD	Underlying shares o/s	Coupon rate on redemption
$60 mn	522	$25 mn	Aug-10	43.39	2.1 mn	39.95%
$50 mn	879	$33 mn	May-11	45.15	1.7 mn	46.99%
$150 mn	1014	$113 mn	May-11	45.15	4.7 mn	46.29%
$260 mn		$171 mn			8.4 mn	

Source: Company & Sunidhi Research

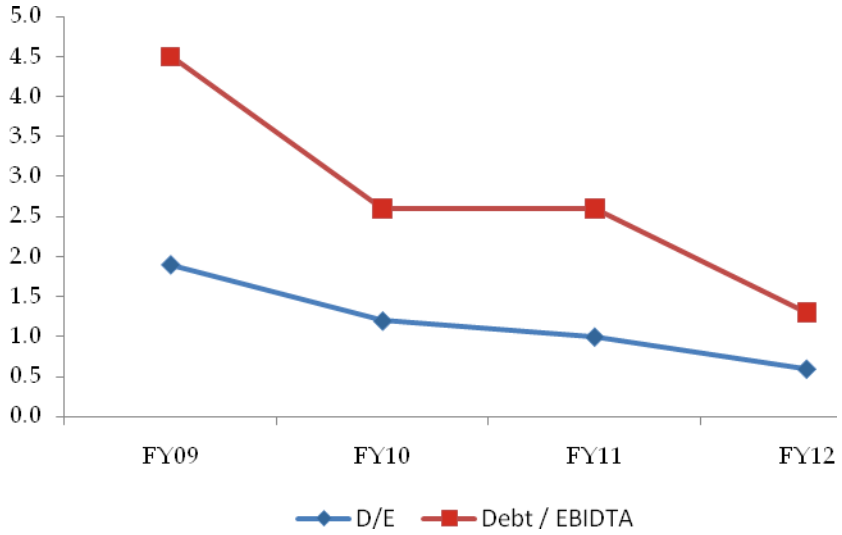
FCCBs worth $139mn will hit redemption in FY12

It is clear from the above table that the last 2 tranches of FCCBs (conversion price Rs.879 and Rs. 1014) still remain out-of-money and the redemption looms around with less than 12 months time left. Taking into account the 46.9% premium on redemption of $33 FCCBs with a conversion price of Rs.879 and 46.3% premium on redemption of $113 FCCBs with a conversion price of Rs.1014 due in the month of May 2011, the company will require another Rs. ~ 9-10bn to redeem these FCCBs. The company plans to raise $100-125mn through ECB route for any shortfall on repayment. The company believes raising fresh money will not be a problem, given the huge Gross Block of ~Rs.25Bn, without any lien.

Will take hit of Rs.2915mn on account of premium on FCCB redemption in FY12

We believe the company's debt position would improve significantly as more and more capacity utilization takes place. The FCCBs form ~ 36% the total debt. We expect the D/E ratio to come down from 1.9x in FY09 to 0.6x by FY12E. Similarly company's Debt/EBIDTA ratio should improve from a high 4.5x in FY09 to 1.2x in FY12E.

Exibit-10: D/E (x) and Debt / EBIDTA (x)



Source: Company & Sunidhi Research

Other Operating Income is entirely Dossier income for sale, licensing and development of Dossiers.

Dossier filing activities to facilitate supply tie-ups

Other Operating Income for the company includes out-licensing of dossiers to MNCs which trigger supply agreements. The company sales dossiers- detailed monographs of non-infringing processes of bio-equivalents, approved sights of manufacturing and procurement of raw materials, which are required to be submitted to different regulatory authorities. In Europe the time taken for filing these Dossiers and getting Marketing Approval (MAs) can be at least 24 months.

For FY10, the Dossier income stood at Rs.1.98bn. This income will remain in the range of Rs.1.50-1.60bn in the coming years, but is expected to tap many clients for supply arrangements.

Changing Industry Dynamics

Companies with integrated model and strong track record will withstand pricing pressure in generics

Drugs worth ~$ 50bn are slated to loose patent exclusivity during 2009-2014 globally, creating huge opportunities for global Generic players. The generic pharmaceutical companies are expected to grow on the back of strong filing momentum and increased volume growth and also drying pipelines from innovators. The stricter norms adopted by the USFDA for the generic companies along with rising pricing pressure in the regulated markets will enable only the stronger and established players to retain their market dominance. Companies with strong presence in branded formulations, chronic segments, novel delivery systems and backing of own raw material sourcing would be able to gain sizeable market share and protect their margins at the same time.

In recent years patent challenges have become the rule rather than exception for generics. According to a study compiled by US based RBC Capital markets, there are approximately 300 active first-to-file paragraph IV challenges, most of which have multiple filers. Patent challenges remain on the rise, with 65 new first-to-file paragraph IV challenges initiated in 2009 (up from 43 and 51 in 2007 and 2008 respectively). The incentive is clear: the first ANDA filer to make a paragraph IV certification receives 180 days of market exclusivity during which no other ANDA can be approved for that drug.

With very little downside and huge upside, exclusivity is the driving force to the huge increase in first-to-file paragraph IV filings.

The overall success rate for the generic industry is 48% based on court decisions. However, when one takes into account patent settlements and cases that were dropped, the success rate for generics jumps to 76%, substantially in favor of challenging patents. This is why generic firms focus on first-to-file opportunities. Settlements provide clarity for the company and shareholders.

Name	Overall success (Cases Won/settled)
Lupin	75%
Sun Pharma	67%
Ranbaxy	63%
Dr.Reddy's	61%

Source: Sunidhi Research

Indian companies enjoy fair amount of overall success rate when it comes to settlements and dropping of cases in the US Generics market. Companies such as Lupin, Sun, Dr. Reddy's and Ranbaxy have established firm footing in this market not only because of wide product basket but also due to settlement success rate.

The in-bound M&A activity by MNC Pharma companies is growing up in India. Drying pipeline of new drugs, increased R&D expenditure required to bring a drug to the market, increased pressure in the developed nations to bring the health care costs down are some of the factors that are responsible for the big MNCs to fine-tune their business models. India, having largest number of FDA approved plant after US, has traditional advantages of competitive manufacturing, R&D cost structures and a high growth domestic market. This is why Indian pharmaceutical industry has generated a lot of interest among the Big Pharma MNCs.

On the Balance sheet front, we observe that majority of the companies have more or less completed the capex cycles mainly funded by external borrowings, for which the companies had to report huge translation losses in FY09. We observe that Indian pharma companies are comfortable with respect to financial leverage and are likely to generate adequate cash to handle the capex requirements over the next two to three years.

US Healthcare Reforms- The Bill Impact

Incremental coverage of uninsured Americans under the health plan to boost generics demand

In a landmark legislation passed in the month of March, the US House of Representatives passed the sweeping health care reform package, extending Medicare coverage to 32 million uncovered Americans. When fully phased in, almost 95% of eligible Americans would have coverage, compared with 83% today. The bill will have long lasting implications on the Indian Pharma industry.

Indian pharma industry is fundamentally based on Generic products. With the highest number of US FDA approved manufacturing facility outside of U.S. and also the highest number of molecules approved by US FDA, India is going to be the obvious choice of US pharma companies when they go shopping for Generics. India was among the 14 countries named in the Congress discussion that can offer low-cost drugs to achieve lower health care costs.

Overall the bill is positive for the Indian generic industry because generics are definitely going to get much better preferences there because ultimately the Obama administration is looking at wider coverage for people who cannot afford healthcare. However the benefit will not flow down overnight. Indian generic players could see runaway growth for the next 7-8 years bolstered by exports after the bill.

While generics form only 19-20% of the US market today, they are likely to make up nearly 46-47% by 2013 when the bill will come into full effect.

The opportunity could be bigger as other developed nations could join the US initiative to cut healthcare costs- Germany is a prime example.

This situation was anticipated by many leading companies like Pfizer, GSK, Sanofi etc, well in advance. The recent in-bound tie-ups are testimony to this- GSK- Dr. Reddy's, Pfizer- Aurobindo, Pfizer- Strides Arcolabs, Hospira- Orchid, GSK- Nectar, Astra Zenecca- Torrent, Sanofi Aventis-Santha Biotech and Watson- Indoco to name a few.

Elimination of "ban on pay for delay" clause from the bill to benefit Indian generic players

Another important point which was dodged by the bill is ban on pay-for-delay settlements between Branded and Generic drug-makers. Dropping the ban on 'pay-for-delay' settlements has come as a surprise for Indian generic companies. Normally in such kind of arrangement, the Innovator companies pay certain amount to the Para IV generic players to delay the generic launch. Thus both the players try to avoid lengthy trial processes hence bringing the Generics before the patent expiry.

We believe companies which have sizable presence in the US by virtue of ANDA filings and USFDA approved production facilities such as Lupin, Sun Pharma, Dr.Reddy's Labs, Ranbaxy, Aurobindo, Glenmark, Torrent, and Cadila will benefit in the long run.

Conclusion and valuation

The revenue mix transformation augurs well for the company, which in the past was stamped with predominantly commoditized API business model. Incremental capacity utilization will also act as an operating leverage to improve the overall profitability. Company owns one of the largest manufacturing bases in India that caters to the US market and until now there are no concerns or observations or warning letters from the USFDA. Its foray into niche segments like CNS, CVS and lately into Oral Contraceptives and High end Penams will optimize the product offerings in the formulation space.

The Pfizer deal has come as a short in arm at a time when the company is scaling up its capacities. It will improve the overall image and infuse steady and incremental cash flows going forward, besides improving the margins.

Dossier filing activity will lead to tapping of potential clients for supply arrangements.

The likely success in the CRAMS foray is not ascertainable at this juncture but looking at the overall CRAMS scenario, we see revival in 6-9 months time, especially after the improved business sentiments in EU leading to improvement in the off-take.

On the flip side the FCCBs redemption will remain an important factor for multiple.
Secondly unlike leading Generic peers, the company does not have strong domestic cushion. All the peers (exhibit) derive ~20-40% sales from domestic branded formulations where as most of Aurobindo's domestic revenue comes from APIs.

The company does not want to go for FTF opportunities aggressively which we think is a bit dampener for the multiple, give the success rates of the Indian companies and the potential involved in exclusivity deals, as discussed above.

Similarly because of export driven business model, the currency fluctuation risk is always there, but this risk will be mitigated to some extend as the company follows natural hedge policy and the net forex exposure is ~30-35%.

The scrip is currently trading at ~5x FY12 EV/EBIDTA, a substantial discount vis-à-vis industry peers because on its legacy API model. But with the kind of transformation, vertically integrated business model, capacity build up in niche segments plus deals with the MNCs as the one with Pfizer, we believe the scrip has the potential for re-rating. We have ascertained a target of Rs. 1334, based on 7x FY12 EV/EBIDTA for 12-15 months investment horizon.

Company Background

Based in Hyderabad, Aurobindo Pharma Limited (APL) is an integrated pharmaceutical company which manufactures generic formulations and active pharmaceutical ingredients. The company's manufacturing facilities are approved by several leading regulatory agencies like US FDA, UK MHRA, WHO, Health Canada, MCC South Africa, ANVISA Brazil. The company's robust product portfolio is spread over 5 major therapeutic/product areas encompassing Antibiotics, ARVs, CVS, CNS and Gastroenterologicals supported by own R&D set-up. The Company is marketing these products globally, in over 125 countries.

Aurobindo Pharma is vertically integrated and its product basket includes about 300+ products. It also owns three R&D centres with about 700+ scientists. The market potential of the company's product pipeline of 300+ products is almost $200bln.

Exibit-11: Manufacturing facilities

Indian Formulation Units	Product Type	Approvals	Capacity utlisation
Unit III	Non-Betalactum	USFDA, UKMHRA, TGA, Health Canada, MCC (SA), ANVISA (Brazil), WHO	High
Unit VIB	Cephs (Oral & Sterlie)	USFDA, Health Canada, MCC (SA), ANVISA (Brazil)	Low
Unit XII	SSPs (Sterile & Non-Sterile)	USFDA, UKMHRA, TGA, Health Canada, MCC (SA), ANVISA (Brazil)	Low
Unit VII (SEZ)	Non-Betalactum	USFDA	Yet to start
Trident	Liquid Injectibles	Waiting for approvals	Yet to start
US Formulation Units			
US NJ	Non-Betalactum (Oral)	USFDA	Low
Indian API Units	**Product Type**	**Approvals**	
Unit I	CNS, CVS, Anti-allergic	USFDA, UKMHRA, TGA, WHO	High
Unit IA	Cephs (Non-Sterlie)	USFDA, UKMHRA, TGA.	High
Unit V	SSPs (Sterile & Non-Sterile)	CGMP	High
Unit VIA	SSPs	USFDA, TGA.	High
Unit VIII	GI, ARV	USFDA, UKMHRA, TGA, WHO	High
Unit XIA	ARV	USFDA, UKMHRA, WHO	High
Intermediates			
Unit IX	Intermediates	CGMP	High
Unit X	Intermediates	CGMP	High
Unit XIA	Intermediates	CGMP	High
China	Fermentation Unit	CGMP	High

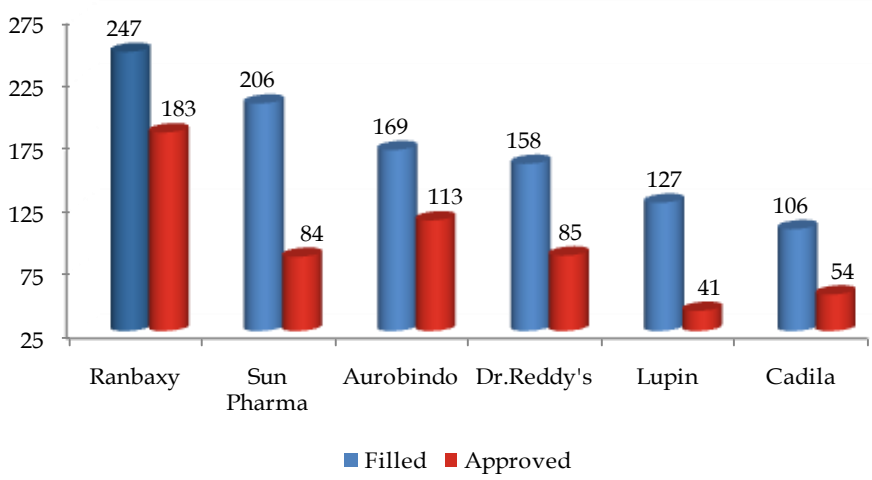
Source: Company & Sunidhi Research

Exibit-12: Peer comparison - valuations

FY12 Consensus Estimates	Market Cap Rs.bn	EV/Sales x	EV/EBIDTA x	P/BV x	Core PE x	ROCE %
Sun Pharma	351	6.0	18.0	4.0	24	17
Cipla	270	4.0	17.0	3.5	18	22
Dr. Reddy's	241	3.0	17.0	5.0	23	19
Ranbaxy (CY11)	186	2.4	25.0	2.4	49	7
Lupin	168	2.8	12.3	5.0	16	32
Cadila	131	2.8	11.2	4.6	16	33
Aurobindo	49	1.2	4.9	1.7	6	24

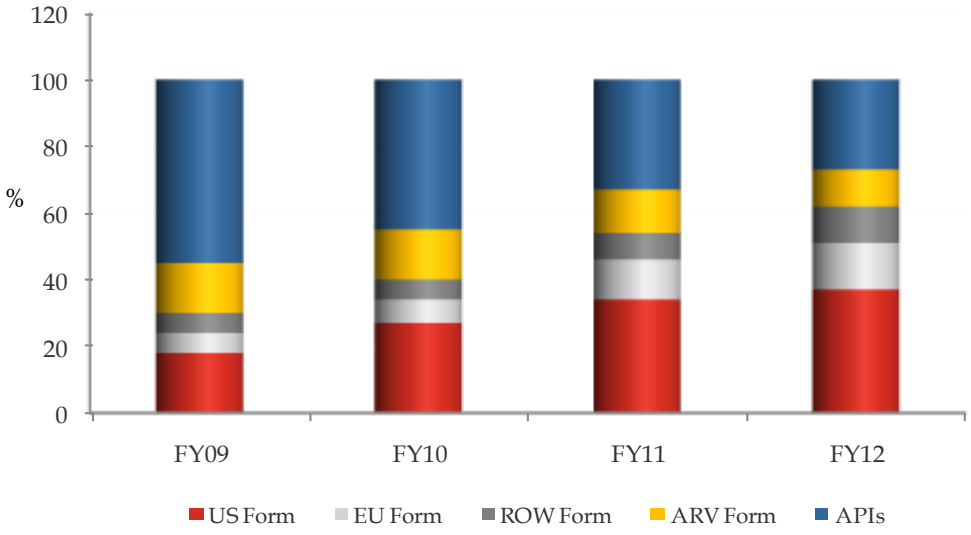
Source: Company & Sunidhi Research

Exibit-13: Peer comparison – ANDA filings as on 31st March 2010



Source: Company & Sunidhi Research

Exibit-14: Base sales – segment breakup



Source: Company & Sunidhi Research

Valuation Summary

	FY07	FY08	FY09	FY10	FY11F	FY12F
Revenues, Rsm	21362.0	24465.9	30773.1	35754.0	41984.8	50320.2
EBITDA, Rsm	3154.7	3518.1	5164.6	8231.5	9960.8	12695.2
Net profit, Rsm	2009.3	2385.9	993.4	5633.7	5826.6	5548.2
Capital Employed, Rsm	29586.4	29652.9	35765.1	39880.0	50842.6	46990.0
Gross Block, Rsm	14681.4	17179.9	19736.3	25099.3	30051.3	33551.3
Net Debts, Rsm	16988.5	16157.0	22053.2	20817.4	16881.9	11769.6
EPS, Rs	37.7	44.4	18.5	101.1	100.8	96.0
Adj EPS, Rs	37.7	44.4	44.7	86.4	94.3	133.8
Adj CEPS, Rs	56.4	63.1	68.5	113.2	122.9	160.6
BVPS, Rs	164.4	207.4	230.7	328.2	429.0	518.0
P/E, x	22.9	19.4	46.6	8.5	8.6	9.0
Adj PE, x	22.9	19.4	19.3	10.0	9.1	6.4
P/Bv, x	5.2	4.2	3.7	2.6	2.0	1.7
EV/EBITDA, x	21.2	18.8	13.9	8.6	6.7	4.9
EV/Sales, x	3.1	2.7	2.3	2.0	1.6	1.2
DPS, Rs		2.5	3.3	4.5	5.0	6.0
Dividend Payout %	8%	9%	28%	6%	7%	7%
Growth Ratios	**FY07**	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
Sales Growth	32%	15%	26%	16%	17%	20%
EBIDTA Growth	64%	12%	47%	59%	21%	27%
EBT (Before Fx chgs / fccb)	108%	41%	10%	100%	12%	42%
Adj NP Growth	184%	19%	1%	100%	13%	42%
Key Ratios	**FY07**	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
EBIDTA %	15%	14%	17%	23%	24%	25%
EBIDITA (Excl Ot.Op.In) %	14%	14%	13%	19%	21%	23%
Adj NPM %	9%	10%	8%	13%	13%	15%
Adj ROE %	23%	21%	19%	26%	22%	26%
ROCE %	7%	8%	11%	17%	16%	24%
D/E x	2.4	1.7	1.9	1.2	1.0	0.6
Debt / EBIDTA x	6.6	5.3	4.5	2.6	2.6	1.3
Interest Coverage x	4.8	5.8	4.6	9.9	6.1	9.6
Turnover Ratios	**FY07**	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
Asset Turnover Ratio x	1.6	1.6	1.6	1.6	1.7	2.2
Inventory Days	112	119	104	113	100	95
Debtors Days	107	99	106	98	95	90

Source: Company & Sunidhi Research

Balance Sheet

Rsm	FY08	FY09	FY10	FY11F	FY12F
Sources of Funds					
Equity Share Capital	268.8	268.8	278.6	289.0	289.0
Reserves & Surplus	10881.9	12135.1	18012.4	24508.6	29651.0
Net Worth	**11150.7**	**12403.9**	**18291.0**	**24797.6**	**29940.0**
Secured Loans	6334.3	9876.7	8640.5	18725.0	16000.0
Unsecured Loans	12135.9	13453.0	12905.2	7275.0	1000.0
Loan Funds	**18470.2**	**23329.7**	**21545.7**	**26000.0**	**17000.0**
Deffered Tax Liabilty	601.4	797.2	953.5	1000.0	1000.0
Total Liabilities	**30254.3**	**36562.3**	**40833.5**	**51842.6**	**47990.0**
Application of Funds					
Gross Block	**17179.9**	**19736.3**	**25099.3**	**30051.3**	**33551.3**
Less: Depreciation	4176.9	5748.6	7242.0	8892.0	10443.0
Net Block	13003.0	13987.7	17857.3	21159.3	23108.3
WIP	2145.5	5363.0	4952.0	3500.0	0.0
Net Fixed Assets	**15148.5**	**19350.7**	**22809.3**	**24659.3**	**23108.3**
Investments	**896.5**	**2.6**	**2.8**	**2.8**	**3.0**
Differed Tax Assets	0.0	21.4	41.7	0.0	0.0
Current Assets					
Inventories	7950.9	8776.3	11024.5	11502.7	13097.0
Debtors	6650.1	8897.6	9560.1	10927.6	12407.7
Cash and Bank	2313.2	1276.5	728.3	9118.1	5230.4
Loans and Advances	3164.1	3869.2	3713.1	3450.8	3446.6
Other Current Assets	0.0	70.1	33.4	50.0	50.0
Current Liabilities	5546.0	5436.4	6728.0	7476.7	8961.1
Provisions	323.0	265.9	351.9	391.9	391.9
Net Current Assets	**14209.3**	**17187.4**	**17979.5**	**27180.5**	**24878.7**
Total Assets	**30254.3**	**36562.1**	**40833.3**	**51842.6**	**47990.0**

Source: Company & Sunidhi Research

Income Statement

Rsm	FY08	FY09	FY10	FY11F	FY12F
Total Revenues	**24465.9**	**30773.1**	**35754.0**	**41984.8**	**50320.2**
Raw Materials	13514.2	16367.4	17210.8	20212.0	24160.0
Manufacturing Expenses	3281.4	3441.3	3519.5	4500.0	5000.0
Employment Costs	1930.0	2436.7	3272.8	3928.0	4714.0
Administrative expenses	2222.2	3363.1	3519.5	3384.0	3751.0
Operating Expenditure	**20947.8**	**25608.5**	**27522.5**	**32024.0**	**37625.0**
EBIDTA	**3518.1**	**5164.6**	**8231.5**	**9960.8**	**12695.2**
Other Income	836.6	167.0	389.4	300.0	300.0
Finance and Interest Costs	432.4	838.6	677.9	1355.3	1165.0
Depreciation	1003.8	1276.0	1493.4	1650.0	1551.0
Forex Gains / losses	0.0	2500.0	-1072.6	-500.0	0.0
Prem on FCCB Redemption	0.0	0.0	0.0	0.0	2915.0
EBT	**2918.5**	**717.0**	**7522.2**	**7755.6**	**7364.2**
Tax	536.0	213.6	1913.6	1939.0	1841.0
Profit after Tax	**2382.5**	**503.4**	**5608.6**	**5816.6**	**5523.2**
Extraordinary items	0.0	-489.5	-21.9	0.0	0.0
Min. Int.	-3.4	-0.5	-3.2	-10.0	-25.0
Net Profit	**2385.9**	**993.4**	**5633.7**	**5826.6**	**5548.2**
Adj. Net Profit	**2385.9**	**2405.0**	**4817.6**	**5451.6**	**7734.4**
Shares Outstanding (nos.)	53.8	53.8	55.7	57.8	57.8
EPS	**44.4**	**18.5**	**101.1**	**100.8**	**96.0**
Adj. EPS	**44.4**	**44.7**	**86.4**	**94.3**	**133.8**

Source: Company & Sunidhi Research

Cash Flow

Rsm	FY08	FY09	FY10	FY11F	FY12F
Operating Profit before WC changes	**3,318**	**4,993**	**8,390**	**11,958**	**13,609**
Movements in WC-					
Inc/Dec in Drs	(297)	(1,790)	(663)	(1,367)	(1,480)
Inc/Dec in Inventory	(1,406)	(683)	(2,248)	(478)	(1,594)
Inc/Dec in Loans & Advances	(692)	(807)	156	262	4
Inc/Dec in Current Liab & Prov	1,124	(60)	1,378	789	1,484
Working Capital Changes	**(1,272)**	**(3,340)**	**(1,377)**	**(795)**	**(1,586)**
Cash Generated from operations	**2,047**	**1,653**	**7,013**	**11,164**	**12,023**
Tax paid	459	302	1,531	1,939	1,841
Net Cash from operating activities (A)	**1,588**	**1,351**	**5,482**	**9,225**	**10,182**
Net Cash from Investing activities (B)	**(883)**	**(4,063)**	**(5,363)**	**(4,952)**	**(3,500)**
Cash Flow from Financing Activities-					
Proceeds from issuance of Equity	15	0	2,120	1,424	0
Proceeds from long term borrowings	30	926	0	0	0
Proceeds from/ Repurchase of FCCBs	0	(1,488)	0	0	0
Repayment of long term borrowings	(1,180)	(481)	(1,784)	4,454	(9,000)
Proceeds from short term borrowings	(259)	3,936	0	0	0
Interest Paid	(625)	(824)	(678)	(1,355)	(1,165)
FCCB Issue Exp	0	0	0	0	0
Dividend and div. Tax paid	(166)	(393)	(326)	(406)	(406)
Net Cash from Financing activities ©	**(2,184)**	**1,676**	**(668)**	**4,117**	**(10,571)**
Net Inc/Dec in cash & cash equivalants (A+B+C)	**(1,480)**	**(1,036)**	**(549)**	**8,390**	**(3,888)**
Cash & Cash Equ. At the beginning of the year	3,793	2,314	1,278	729	9,119
Cash & Cash Equ. At the end of the year	**2,314**	**1,278**	**729**	**9,119**	**5,231**

Source: Company & Sunidhi Research

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