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Deutsche Bank

Aurobindo Pharma

Reuters: **ARBN.BO** Bloomberg: **ARBP IN** Exchange: **BSE** Ticker: **ARBN**

Normalisation post one-offs restrained 1H; cut estimates

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Normalisation of operations after one-off driven weak-1H to drive 2H
Everything that could go wrong, did in 1H - FDA issues at 2 units leading to shutdown to improve processes were aggravated by logistical issues. This was exacerbated by poor mix & its operating leverage. Normalisation since Nov will drive production, product-mix & margins. Company is on-track to address FDA issues. We expect positive free cashflow from next 1H. Other concerns seem overdone. Cut estimates mainly for current fiscal and TP by 25%. Maintain Buy

1H marred by one-time headwinds with 2H now 'normalising'
1H was adversely impacted by (a) plant shutdowns to upgrade most facilities post US FDA (FDA) issues (b) political turbulence in Hyderabad crippling power & logistics constraining production and driving costs (c) its high operating leverage & poor mix and (d) INR collapse. Normalisation of production constraints since Nov will drive 2H. It guides USD 250m+ rev from 3Q against USD 220 in 2Q. Mkt-share gains & new approvals in US, new markets and CRAMs will be future drivers.

On-track to address FDA issues, while other concerns seem overdone
With 3 units being re-approved by FDA in CY11, APL is confident of getting re-approvals of another 6 units in this fiscal. It guides for re-approval of Units III & VI by 4QFY12e & 1QFY13e respectively. Despite headwinds, operational cashflows of ~INR 2bn in 1H was neutralised by the INR 3bn capex. With a bounce-back in 2H & lower capex in future, we expect free cashflows by 1HFY13e. Though its net debt (~INR 30bn) & net gearing (130%) have risen, only 15% is due in 18m. Concerns on promoter pledging due to fall in stock price are overdone as (a) post margin calls, pledging has increased to 20%, which is amongst the lowest since Mar'09 (b) promoters have also started raising stake, which in the past (2HFY09) had coincided with bottoming of the stock price.

Cut estimates by upto 33%, TP by 25% to INR 150/ share, maintain Buy
With poor 1H, we cut FY12 estimates by 33% with modest cuts of upto 16% in FY13-14e. Cut TP by 25% to INR 150 (11.6x FY12e EPS, 45% discount to sector). With 65% upside, maintain Buy. Risks: Addressing FDA issues & execution.

Forecasts and ratios

Year End Mar 31	2010A	2011A	**2012E**	2013E	2014E
Sales (INRm)	33,777.0	41,259.0	**45,875.5**	54,555.6	64,349.0
EBITDA (INRm)	6,254.5	7,041.7	**6,136.7**	8,778.1	11,092.4
Reported NPAT (INRm)	4,809.6	5,365.2	**3,765.6**	5,985.7	7,391.4
Reported EPS FD(INR)	16.48	18.43	**12.94**	20.56	25.39
DB EPS FD(INR)	16.48	18.43	**12.94**	20.56	25.39
OLD DB EPS FD(INR)	16.48	18.43	**19.13**	24.59	28.00
% Change	0.0%	0.0%	**-32.4%**	-16.4%	-9.3%
DB EPS growth (%)	78.2	11.9	**-29.8**	59.0	23.5
PER (x)	8.2	11.5	**7.0**	4.4	3.6
EV/EBITDA (x)	9.6	11.9	**9.2**	6.0	4.4

Source: Deutsche Bank estimates, company data

[1] DB EPS is fully diluted and excludes non-recurring items
[2] Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Forecast Change

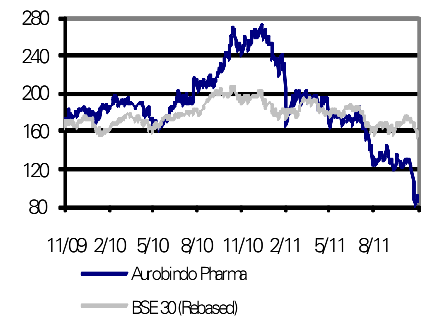
Buy

Price at 24 Nov 2011 (INR)	**90.75**
Price target - 12mth (INR)	**150.00**
52-week range (INR)	**271.85 - 82.35**
BSE 30	**15,858**

Key changes

Price target	200.00 to 150.00 ↓	**-25.0%**
Sales (FYE)	45,640 to 45,875 ↑	**0.5%**
Op prof margin (FYE)	12.8 to 9.3 ↓	**-27.5%**
Net profit (FYE)	5,568.9 to 3,765.6 ↓	**-32.4%**

Price/price relative



Performance (%)	1m	3m	12m
Absolute	*-26.0*	*-30.5*	*-63.0*
BSE 30	*-6.4*	*-2.6*	*-18.5*

Stock data

Market cap (INRm)	**26,417**
Market cap (USDm)	**507**
Shares outstanding (m)	**291.1**
Major shareholders	**Promoters (54.6%)**
Free float (%)	**43**
Avg daily value traded (USDm)	**3.1**

Key indicators (FY1)

ROE (%)	**15.9**
Net debt/equity (%)	**134.6**
Book value/share (INR)	**78.10**
Price/book (x)	**1.2**
Net interest cover (x)	**5.2**
Operating profit margin (%)	**9.3**

Model updated:24 November 2011

Running the numbers

Asia

India

Pharmaceuticals/Biotechnology

Aurobindo Pharma

Reuters: ARBN.BO Bloomberg: ARBP IN

Buy

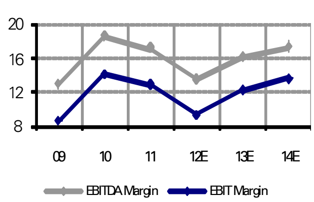
Price (24 Nov 11)	INR 90.75
Target price	INR 150.00
52-week Range	INR 82.35 - 271.85
Market Cap (m)	INRm 26,417 USDm 507

Company Profile

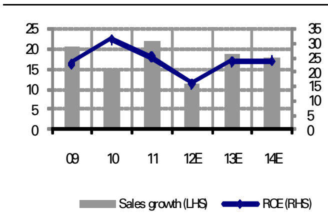
Aurobindo pharma Limited is an integrated player in a wide range of pharmaceutical products. It started off as a producer of a wide range of antibiotics and now produces a range of anti-AIDS drugs, analgesics, anti-inflammatory and anti-ulcerant drugs. Aurobindo sells its products in most unregulated markets, US and parts of Europe.

Price Performance

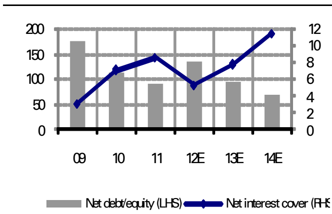
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 31-Mar	2009	2010	2011	2012E	2013E	2014E
Financial Summary						
DB EPS (INR)	9.24	16.48	18.43	12.94	20.56	25.39
Reported EPS (INR)	9.24	16.48	18.43	12.94	20.56	25.39
DPS (INR)	0.90	1.00	2.00	0.75	2.00	3.00
BVPS (INR)	46.3	65.8	84.3	78.1	96.3	118.2
Weighted average shares (m)	292	292	291	291	291	291
Average market cap (INRm)	13,611	39,524	61,612	26,417	26,417	26,417
Enterprise value (INRm)	35,662	60,338	83,489	56,632	52,882	49,232
Valuation Metrics						
P/E (DB) (x)	5.0	8.2	11.5	7.0	4.4	3.6
P/E (Reported) (x)	5.0	8.2	11.5	7.0	4.4	3.6
P/BV (x)	0.82	2.91	2.32	1.16	0.94	0.77
FCF Yield (%)	nm	3.9	nm	nm	16.8	17.7
Dividend Yield (%)	1.9	0.7	0.9	0.8	2.2	3.3
EV/Sales (x)	1.2	1.8	2.0	1.2	1.0	0.8
EV/EBITDA (x)	9.4	9.6	11.9	9.2	6.0	4.4
EV/EBIT (x)	14.2	12.7	15.7	13.3	8.0	5.6
Income Statement (INRm)						
Sales revenue	**29,349**	**33,777**	**41,259**	**45,875**	**54,556**	**64,349**
Gross profit	**12,981**	**16,566**	**19,366**	**21,011**	**25,641**	**30,566**
EBITDA	**3,787**	**6,255**	**7,042**	**6,137**	**8,778**	**11,092**
Depreciation	1,276	1,493	1,715	1,887	2,132	2,345
Amortisation	0	0	0	0	0	0
EBIT	**2,511**	**4,762**	**5,327**	**4,250**	**6,646**	**8,747**
Net interest income(expense)	-839	-678	-625	-812	-853	-767
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	-361	273	106	-938	0	0
Other pre-tax income/(expense)	1,601	2,367	2,808	992	1,688	1,259
Profit before tax	**1,216**	**7,523**	**7,882**	**-1,822**	**7,482**	**9,239**
Income tax expense	214	1,914	2,251	-273	1,496	1,848
Minorities	0	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**2,698**	**4,810**	**5,365**	**3,766**	**5,986**	**7,391**
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	**2,698**	**4,810**	**5,365**	**3,766**	**5,986**	**7,391**
Cash Flow (INRm)						
Cash flow from operations	**-1,248**	**6,512**	**2,947**	**-2,120**	**5,931**	**6,672**
Net Capex	-5,479	-4,952	-3,328	-5,964	-1,500	-2,000
Free cash flow	**-6,727**	**1,560**	**-381**	**-8,083**	**4,431**	**4,672**
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-283	-324	-681	-255	-681	-1,022
Net inc/(dec) in borrowings	4,859	-1,784	2,598	7,357	-3,500	-3,500
Other investing/financing cash flows	4	0	-382	0	0	0
Net cash flow	**-2,147**	**-548**	**1,154**	**-982**	**250**	**150**
Change in working capital	*-4,017*	*-1,338*	*-5,926*	*-2,457*	*-2,186*	*-3,065*
Balance Sheet (INRm)						
Cash and other liquid assets	1,277	728	1,882	900	1,150	1,300
Tangible fixed assets	19,351	22,809	24,422	28,500	27,868	27,523
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	3	3	385	385	385	385
Other assets	21,613	24,331	32,040	34,936	38,265	42,466
Total assets	**42,243**	**47,871**	**58,729**	**64,721**	**67,668**	**71,673**
Interest bearing debt	23,330	21,546	24,144	31,500	28,000	24,500
Other liabilities	6,469	7,992	10,046	10,486	11,629	12,764
Total liabilities	**29,799**	**29,537**	**34,190**	**41,986**	**39,629**	**37,264**
Shareholders' equity	12,444	18,334	24,540	22,735	28,039	34,409
Minorities	0	0	0	0	0	0
Total shareholders' equity	**12,444**	**18,334**	**24,540**	**22,735**	**28,039**	**34,409**
Net debt	*22,053*	*20,817*	*22,261*	*30,600*	*26,850*	*23,200*
Key Company Metrics						
Sales growth (%)	20.5	15.1	22.2	11.2	18.9	18.0
DB EPS growth (%)	13.3	78.2	11.9	-29.8	59.0	23.5
EBITDA Margin (%)	12.9	18.5	17.1	13.4	16.1	17.2
EBIT Margin (%)	8.6	14.1	12.9	9.3	12.2	13.6
Payout ratio (%)	9.7	6.1	10.9	5.8	9.7	11.8
ROE (%)	22.8	31.3	25.0	15.9	23.6	23.7
Capex/sales (%)	18.7	14.7	8.1	13.0	2.7	3.1
Capex/depreciation (x)	4.3	3.3	1.9	3.2	0.7	0.9
Net debt/equity (%)	177.2	113.5	90.7	134.6	95.8	67.4
Net interest cover (x)	3.0	7.0	8.5	5.2	7.8	11.4

Source: Company data, Deutsche Bank estimates

Normalisation after poor 1H, which was driven by one-offs

1H marred by multiple one-off adverse events

FDA issues in 1HCY11 constrain production for entire company from May-Aug…

FDA issues at Unit VI & III in 1HCY11

- On 23 Feb'11, Aurobindo (APL) announced that FDA has issued an Import Alert (IA) that prevented the import of any generics manufactured at APL's Unit VI from 7 Feb'11. Unit VI produced cephalosporins for multiple markets and had US rev. of ~USD 30m (ie ~3% of its FY11 revenues of USD 916m) as only a few ANDAs were pending approvals
- In May'11, it received Warning Letter (WL) for 2 units – Units VI (as expected) & Unit III. The WL stated that while the inspection of Unit III in Sept'10 went off satisfactorily, Aurobindo has withdrawn a few batches of drugs produced at Unit III due to mislabeling in Mar'11. It also cited similar events in Jan'10 and Apr'10. Hence, FDA wanted a detailed action plan for Unit III as well.

Shutdowns in most plants from May-Aug'11 to upgrade processes

- Post the FDA issues, Aurobindo decided to upgrade its production processes across plants. Hence, manufacturing units were shut-down for short period to facilitate this upgradation.

Most plants also see multiple inspections constraining production

- Most units were also inspected by APL's appointed external consultants and companies with whom APL has large supply arrangements (including Pfizer). Typically during the period around inspections, production is constrained as it gets the secondary focus

Most units saw the last 2 activities from May to Aug'11 that constrained production.

…political issues at Hyderabad cripple production in late Aug-mid Oct…

Logistics & power constrained production from late Aug-mid Oct

In late Aug'11, political turmoil erupted in Hyderabad, where 10 of APL's 12 units focusing on US are located (including the recently commissioned large SEZ unit). This was also accompanied by significant power blackouts as the workers of coal mining companies went on a strike. This resulted in the following

- Significant disruptions in production on account of logistical problems in raw material; sourcing and significant power shortages
- Shortfall in dispatches due to logistical bottlenecks -
- Higher cost of power (as backup power is very expensive) and logistics
- Poor product-mix

…constrained rev growth of 2% in 2Q against 16% CAGR in last decade

Sales backlog in late Sept with 2Q rev growth of only 2%

Aurobindo's 2QFY12 revenues grew by 2% yoy as against 16% CAGR recorded in last decade (Figure 1). Company indicates that it has significant sales backlog by late Sept.

Inferior mix, higher costs & operating leverage squeeze margins

330bps increase in material costs/ revenues…

- Production constraints also resulted in inferior mix in 2Q revenues
  - Low-margin bulk ARVs grew 99% yoy to ~16% of rev against only 8% in 2QFY11
  - High-margin formulations, which have been increasing contribution to revenues, declined to 56% in 1H from 59% in FY11. Within formulations, contribution by low margin ARVs increased to 32% in 1H from 28% in FY11.

This resulted in material costs/ revenues spiking by 330bps yoy and 230bps sequentially to 56.5% in 2QFY12

...one-time hiring cost in Europe...

- While high inflation drove 16% yoy increase in other expenses, staff costs too increased by 24% yoy due to (a) hiring of manpower (~15% of manpower addition was in Europe, ~15% in US for its subsidiary Auromeds & OTC business and balance in India). It indicates that new hiring of 25 representatives in Portugal and 30 in Spain resulted in additional staff costs of ~INR 150m, of which ~INR 90m is one-time hiring expense.

...& high operating leverage due to commissioning of large units...

- Since Dec'09, commissioning of its 2 large formulation capacities (Hyderabad SEZ and at New Jersey) significantly increased Aurobindo's operating leverage, as most fixed and semi-fixed costs have been flowing into P&L, while product approvals are slowly coming in resulting in their low capacity utilisation.

...coupled with ~70% decline in dossier income from Pfizer...

Change in Pfizer's strategy for generics mar dossier income

Unlike earlier envisaged aggressive launches across Europe, Pfizer now plans phased launch in select European countries due to aggressive price cuts in Europe. This change in strategy has constrained dossier income for 1H at INR 342m (-69% yoy). Management expects dossier income of ~USD 40m from Pfizer, spread equally over next 8 quarters.

...constrained 1HFY12 financials

Thus poor 1H P&L...

- Thus, poor revenue growth coupled with one-off costs and high operating leverage constrained Aurobindo's 2QFY12 interims with EBITDA (INR 1.0bn) and adjusted PAT (ex-forex, INR 0.3bn) declining by 46% & 77% respectively.
- Hence, despite robust 1Q interims, 1H EBITDA (INR 2.4bn) and adjusted PAT (ex-forex, INR 1.0bn) declined by 23% and 57% respectively (see Figure 1 below).

...as also Balance Sheet

- In 1Q, outstanding FCCBs were redeemed with APL taking a charge of INR 3.2bn of cumulative interest on its P&L. In the 2Q, it had translation loss of INR 1.85bn in its P&L. Both these items constrained equity while boosting debt with gearing shooting to 130% from 91% in Mar'11
- Despite INR depreciation, working capital was under control with inventories & debtors increasing by only 6% and 3% respectively on sequential basis in 1H.

Figure 1: 1H financials marred by multiple adverse one-off issues

Y/E Mar, INR m	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	1HFY12	CAGR (FY01-11)
Revenues	9,492	9,754	12,599	15,046	13,216	15,936	21,229	24,359	29,349	33,777	41,259	21,180	16%
-% Formulations							33%	41%	48%	55%	59%	56%	
- Of which ARVs							41%	40%	33%	27%	28%	32%	
EBITDA	1,295	1,224	1,898	2,213	1,152	1,776	3,022	3,411	3,787	6,255	7,042	2,444	18%
- margin (%)	13.6%	12.5%	15.1%	14.7%	8.7%	11.1%	14.2%	14.0%	12.9%	18.5%	17.1%	11.5%	
Dossier Income													
Recurring PAT	683	604	871	1,068	52	712	2,020	2,381	2,689	4,810	5,365	954	25%
Growth (%)													
Revenues		3%	29%	19%	-12%	21%	33%	15%	20%	15%	22%	10%	
EBITDA		-6%	55%	17%	-48%	54%	70%	13%	11%	65%	13%	-23%	
Recurring PAT		-12%	44%	23%	-95%	1257%	184%	18%	13%	79%	12%	-57%	
As % of revenues (%)													
Raw materials	68.4%	70.2%	65.7%	57.2%	58.0%	59.8%	57.5%	55.5%	55.8%	51.0%	53.1%	55.4%	
Labour	2.3%	2.6%	3.4%	4.8%	6.8%	6.4%	7.1%	7.9%	8.3%	9.7%	10.4%	12.1%	
Other costs	15.6%	14.7%	15.8%	23.4%	26.4%	22.6%	21.1%	22.6%	23.0%	20.8%	19.5%	21.0%	
Balance Sheet													
Net Fixed Assets	1,715	2,260	7,415	8,805	11,108	12,335	13,713	15,148	19,351	22,809	24,422	26,984	
Inventory	1,730	1,255	2,556	3,194	3,755	4,718	6,544	7,950	8,776	11,025	14,553	15,432	
Debtors	2,013	3,676	4,348	4,777	4,533	5,822	6,261	6,650	8,898	9,560	12,434	12,796	
Net Debt	2,214	3,249	6,468	7,609	9,746	11,711	14,957	15,047	22,053	20,817	22,261	29,624	
Equity	2,766	3,618	4,755	7,043	7,145	8,172	8,895	11,271	12,444	18,334	24,540	22,791	
Net gearing (%)	80%	90%	136%	108%	136%	143%	168%	134%	177%	114%	91%	130%	

Source: Company, Deutsche Bank

Normalisation of 2H operations to drive financials

Production now seems to have normalised at all manufacturing units

- APL indicates that political situation in Hyderabad has stabilized since mid Oct
- With most plants already being upgraded, it does not plan any further shutdown in near term

Guidance of USD 250m+ qtr rev against USD 220m in 2Q

Hence, production has normalised since Nov'11. Company guides for quarterly revenue run-rate of USD 250m+ against USD 220m in 2Q.

Normalised volumes, mix and costs with operating leverage to drive 2H

- APL indicates that costs have also normalised since mid Oct
- This will enable the company to optimize product-mix and drive operating leverage.

On-track to tackle FDA issues, other concerns overdone

APL is confident of addressing FDA issues in next 3 quarters

Files for inspection of Unit III & expects to do so for Unit VI by Feb'12e

- 2 formulation units have cGMP issues with FDA: While FDA imposed an Import Alert (IA) on Unit VI in Feb'11, it issued a Warning Letter (WL) on Unit III in May'11.
- It has since upgraded most of its facilities: APL appointed external consultants and has since upgraded most of its facilities.

Guides for re-approval of Unit III & VI by Mar'12e & Jun'12e respectively

- Applies for inspection of Unit III and will do so for Unit VI shortly: APL has applied for inspection of Unit III and expects this facility to be reapproved by end of fiscal. Post the audit of the upgraded Unit VI by external consultants in Feb'12e, it will file for FDA approval and expects the re-approval by mid CY12e.

3 units got re-approved by FDA ytd

With 3 of its 12 units been inspected & re-approved by FDA ytd, APL is confident on inspection of 6 units due in this fiscal

- APL has 12 facilities – 7 formulations and 5 APIs – that export to US
- Post the inspections of Unit III & VI in Sept'10 & Dec'10 respectively, FDA inspected and re-approved 3 other facilities of APL - Unit 1 in Jan11, Unit 8 in June11) & Unit 5 in Sept 11
- APL states that 6 more units are due for inspection in this fiscal (including Unit III). As most of these have been inspected by external consultant in this fiscal and some by Pfizer Inc, APL is confident of their successful re-approval.

Receives 4 ANDA approvals in this quarter

With 4 ANDA approvals from 1 Oct'11, investor concern on no ANDA approval in 3QCY11 is unwarranted

- There have been some investor apprehensions as APL did not receive any ANDA approval in 3QCY11
- However since 1 Oct'11, it has received approvals for 4 ANDAs
  - Gabapentin on 6th Oct
  - Naproxen sodium on 31st Oct
  - Naproxen on 8th Nov
  - Lamivudine on 17th Nov

Other drivers beyond FY12 that will drive revenue & margins

High-potential products approved recently or to be approved in near term in US

APL expects a few of recent approvals (generic Tazobactum in May'11), gabapentin (Oct'11) and 1-2 near-term approvals to be high-volume products that could offer total annual revenues of ~USD 50m in US.

Launch of non-cephalosporin based injectibles & OTC drugs in US & branded generics in S. Europe without any further increase in overheads

- APL expects approvals for non-cephalosporin antibiotic injectibles from FDA from Unit XII in early CY12e. It also expects approvals for OTC products in US by end of this fiscal
- It also expects approvals for its filed products in Spain & Portugal from early CY12e.

Having already setup marketing and distribution teams for above products, it expects revenues without any increase in overheads.

Large pipeline of ANDAs awaiting approvals in US including niche products

- APL has a large pipeline of ~84 ANDAs awaiting approvals with FDA. APL indicates that once Unit III gets re-approved (by end of this fiscal), 5-6 of the 12 ANDAs pending approval from this plant will get approved within a short time.
- It expects approvals for limited competition products - penems and non-antibiotic injectibles from its new units at Delhi and Hyderabad respectively - from late CY12e.

High-margin CRAMS business

APL plans to capitalise on its (a) large, vertically integrated and underutilized manufacturing infrastructure (b) trained manpower in product development in targeting high-margin CRAMs. It has quite a few projects in advanced stages and expects them to be commercialized in next 1-2 years.

Positive free cashflow by 1HFY13e

Despite headwinds, ~INR 2bn cashflow from operations in 1H…

Despite weak operations, 1H operational cashflow was ~INR 2bn

- In 1H, APL's gross & net debt increased by INR 6.3bn & INR 7.4bn respectively
- Our analysis indicates outgo was to the tune of INR 9.3bn in 1H (Figure 2) driven by bullet redemption of outstanding FCCBs (including bullet payment of cumulative interest) in May'11, capex and translation on forex debt.
- Thus, we arrive at operational cashflow of ~INR 2bn, which largely ties up with INR 1.6bn from adjusted PBT.

…was neutralised by the large capex of INR 3bn

- Thus, it was the high 1H capex of INR 3bn that resulted in negative free cashflow in 1H.

Normalisation of operations & lower capex to result in positive free cashflows by 1HFY13e

- With a significant increase in volumes and product-mix, we expect robust growth in revenues and margins from Nov'11. Company guides for USD 250m+ quarterly revenue from 3Q against ~USD 220m in 2Q.

Capex guidance of INR 3bn in next 18m & INR 1bn annually thereafter

- It guides for a capex of INR 3bn in next 18m followed by annual maintenance capex of ~INR 1bn. Post Apr'12r, it indicates that future capex will be restricted to maintenance capex of ~INR 1bn annually till FY15e.

Both the above are expected to drive positive free cashflows from 1HFY13e

Figure 2: Despite weak operations, 1HFY12 operational cashflow was ~INR 2bn

As on (INR m)	31 Mar'11	30 Sept'11	Change	Cashflow	Comment/ Source
Gross debt	24,144	30,458	6,314		
Cash	1,882	834	-1,048		
Net debt (A)	22,262	29,624	7,363		
Closing INR/ USD	44.7	49.0	(4.3)		INR depreciation
Net debt (USD m)	498	605			
Equity	24,539	22,791			
Net gearing	91%	130%			
Working capital excl. cash	23,177	24,952			Driven by INR depreciation
Repayment of interest on FCCB				3,199	1Q interim
Impact of translation on forex debt				2,440	INR 4.28 on ~USD 570m (498m on 1 Apr & 70m on FCCB repaid)
Final dividend				342	INR 1/share paid in Aug'11
Interest paid in 1H				353	1H interim
Capex in 1H				3,000	Company
Total (B)				9,333	
Operational cashflow (B-A)				1,971	

Source: Company, Deutsche Bank

Debt, though high, is largely LT in nature

- APL states that most of its gross debt (~USD 620m on Sept'11) is forex denominated.
- ~65% of this debt (~USD 400m) is working capital and hence perpetual in nature as we expect APL to continue its momentum in revenue growth.
- Of the balance USD 220m debt, USD 125m is ECB which is due after 4.5 years
- Only ~90m of this debt is due for repayment in next 18m
- APL is confident of financing this through internal accruals and refinancing.

Only ~USD 90m debt is due in next 18m

Does promoter buying indicate bottoming of stock as seen in 1QCY09?

Promoters raised stake during global crisis (2HFY09) creating a bottom (Figure 3)
During global crisis, promoter holding increased from 55.3% in Sept'08 to 59.9% as the stock price collapsed. This probably resulted in 71% of their stake being pledged. The stock bottomed out in Mar'09 in-line with bottoming of global and Indian equity markets.

Through pledging, promoters supported stock in global crisis

Promoters revoke pledging in CY09-10 with stake falling due to conversion of FCCBs
Promoter pledging dropped from 72% in Mar'09 to 19% in Dec'10 by partly selling some stake (59.9% in Mar'09 to 59.0% in Jun'09). Their stake fell further to 54.4% in Sept'10 almost entirely due to the partial conversion of some 0-coupon convertibles in that period.

Pledging falls from 72% in Mar'09 to 19% in Dec'10

On stronger fundamentals now compared to late CY08

- It is only the one-off adverse events in current 1H that constrained financials
- Current gearing of 130% is much lower than the 177% in Mar'09 (Figure 3)
- Moreover, most of the current debt is due at face value in 4-5 years. Most of the Mar'09 debt was due in 2-4 years and was repayable at a premium as it was out-of-money 0-coupon convertibles

Promoters seem to have repaid loans & further unlocked pledges in 3QCY11
Despite the continual fall in stock price from a peak in current calendar, promoter pledging fell to 14.4% in Sept'11 indicating debt repayment.

Disclosures since 30 Sept'11 indicate that promoters raise holding & pledging
Since 30 Sept'11, disclosures to stock exchanges indicate the following

- Promoters have acquired 0.5m shares (~0.2% of total equity) since 1 Oct and largely in this week raising their stake to 54.6%
- Pledging has increased from 14.4% to 20.7%. We believe that this would be on account of (a) fund raising to purchase the 0.5m shares and/ or (b) margin calls post the continual fall in stock price since 1 Sep'11.
- However at 21% of promoter holding, pledging is amongst the lowest since Mar'09

Pledging rises to 21% (amongst lowest since Mar'09) probably due to margin calls

Figure 3: Will improving fundamentals & rising promoter stake drive stock price, as seen in 1Q'CY09?

Date	Stock Price	Equity	Promoter Holding	Holdings pledged	N.Debt	Net Gearing	INR/ USD	Rev	EBIDTA	PBT pre forex	Comments
	(INR)	(m)	(%)	(%)	INR bn)	(%)		(INR m)	(INR m)	(INR m)	
31-Mar-08	58	53.8	55.3%		15.0	134%	40.1	7,056	994	705	
30-Jun-08	54	53.8	55.3%				43.0	6,797	1,109	757	
30-Sep-08	55	53.8	55.3%				47.0	7,010	1,165	842	
31-Dec-08	34	53.8	57.8%				48.8	7,351	701	1,066	Promoters raise stake in crisis leading to pledges
31-Mar-09	38	53.8	59.9%	71.7%	22.1	177%	50.7	8,500	1,173	1,194	With most debt being in forex, weak INR boosts net debt
30-Jun-09	93	53.8	59.0%	33.4%			47.9	8,097	1,526	1,420	Most debt due in 2-3 years
30-Sep-09	156	53.8	59.0%	32.0%			48.1	8,424	1,667	1,645	
31-Dec-09	182	53.8	58.7%	29.5%			46.5	8,246	1,583	1,997	
31-Mar-10	192	54.0	56.9%	29.5%	20.8	114%	44.9	9,011	1,479	1,389	Phased FCCB conversion boost equity & dilute promoters
30-Jun-10	182	55.7	56.2%	19.7%			46.5	8,837	1,331	1,219	- do -
30-Sep-10	208	56.5	54.4%	21.4%	21.5	99%	44.9	10,427	1,843	2,048	- do -
31-Dec-10	263	58.2	54.4%	18.8%			44.7	10,720	1,992	2,707	
31-Mar-11	196	58.2	54.4%	19.2%	22.3	91%	44.6	11,277	1,876	1,538	FDA issues hurt stock
30-Jun-11	172	291.1	54.4%	20.4%			44.7	10,580	1,451	1,072	
30-Sep-11	124	291.1	54.4%	14.4%	29.6	130%	49.0	10,600	993	536	Fall in pledges post repayment, weak INR drives net debt
24-Nov-11	90	291.1	54.6%	20.7%			52.3				Poor 2Q hurts stock leading to margin calls.
											Promoters raise stake. Most debt is due over 3-4 yrs

Source: Company, Deutsche Bank

Financials, Valuations & Risks

Cut estimates mainly for FY12e

- Considering its poor product mix in 2Q and high operating leverage, we cut EBITDA by upto 19% and PAT by upto 32% for FY12e
- Normalisation of production and weak INR benefits neutralise lower sourcing by Pfizer resulting in raising revenue estimates by upto 3% for FY13-14e
- However comparatively weaker mix force us to cut EBITDA by upto 11% for FY13-14e. Despite the INR depreciation, we cut dossier incomes from Pfizer. Thus upto 16% cut in adjusted PAT in that period.

Figure 4: Significant cut in FY12e estimates as normalizing of events will see limited impact latter

INR m	Previous estimates			Current estimates			% change		
Year to Mar	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e
Sales	45,640	54,053	62,664	45,875	54,556	64,349	0.5%	0.9%	2.7%
EBITDA	7,578	9,893	11,720	6,137	8,778	11,092	-19.0%	-11.3%	-5.4%
Dossier Income (Pfizer)	846	1,269	799	635	1,210	761	-25.0%	-4.7%	-4.7%
Adjusted PAT	5,569	7,159	8,150	3,766	5,986	7,391	-32.4%	-16.4%	-9.3%

Source: Deutsche Bank

Cut Target Price (TP) by 25% to INR 150/ share, maintain Buy

Considering that APL is (a) largely a commodity play (45% of revenues from low-margin and volatile APIs) and (b) no exposure to high-margin and stable branded generics in semi-regulated markets as compared to peers, we attribute a discount to Mar'12e sector PE. However, with FY12e financials being significantly impacted by adverse one-off events, and with better outlook, we reduce the discount to 45% (from 55% earlier) and cut TP by 25% to INR 150 (11.6x Mar'12e). With ~65% upside, we maintain Buy.

Risks

Downside risks include:

- Delay in plant re-approval from regulatory agencies including Unit III & Unit VI, which are facing issues with the US FDA;
- Execution risks due to (i) increasing complexity of logistics given the sharp increase in the number of product approvals across markets and (ii) political turbulence in Hyderabad, its key manufacturing location;
- pricing pressure on generics across key markets; and
- INR appreciation.

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist			
Company	**Ticker**	**Recent price***	**Disclosure**
Aurobindo Pharma	ARBN.BO	90.75 (INR) 24 Nov 11	NA

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

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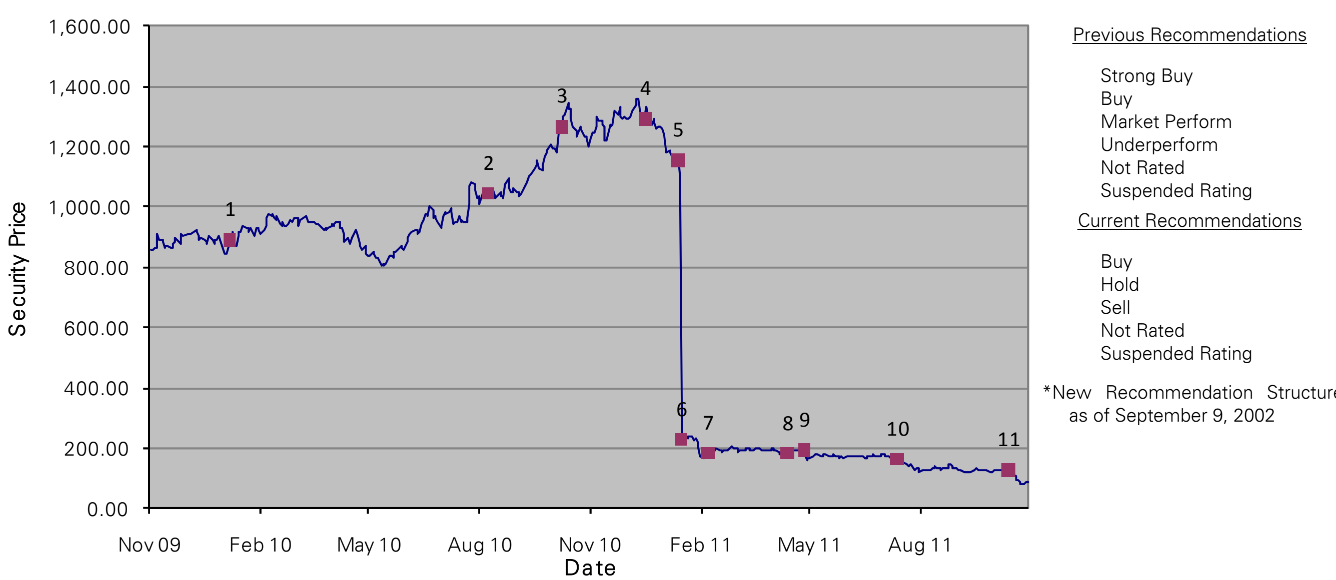
Historical recommendations and target price: Aurobindo Pharma (ARBN.BO)

(as of 11/24/2011)



1.	1/2/2010:	Buy, Target Price Change INR1,060.00	7.	4/3/2011:	Buy, Target Price Change INR280.00
2.	3/9/2010:	Buy, Target Price Change INR1,200.00	8.	9/5/2011:	Buy, Target Price Change INR270.00
3.	3/11/2010:	Buy, Target Price Change INR1,500.00	9.	23/5/2011:	Buy, Target Price Change INR245.00
4.	11/1/2011:	Buy, Target Price Change INR1,600.00	10.	8/8/2011:	Buy, Target Price Change INR220.00
5.	7/2/2011:	Buy, Target Price Change INR1,525.00	11.	8/11/2011:	Buy, Target Price Change INR200.00
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Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.
Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock
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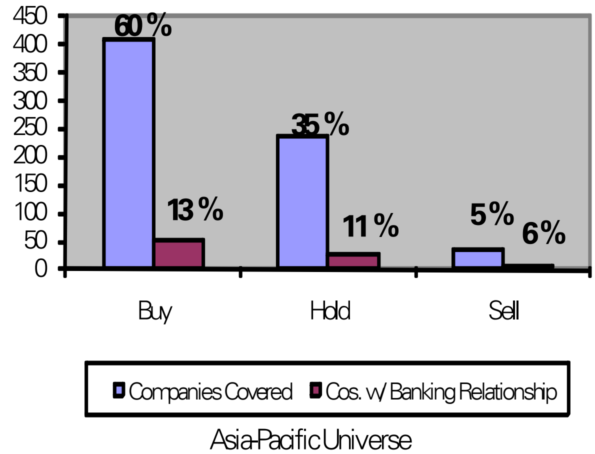
   Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period
   Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships



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