MOTILAL OSWAL

17 January 2019

Update | Sector: Healthcare

Aurobindo Pharma

BSE SENSEX	S&P CNX
36,374	10,905

AUROBINDO

CMP: INR775 **TP: INR940(+21%)** **Buy**

Enhances specialty portfolio by acquiring Spectrum's oncology products

Deal attractively valued

- **Aurobindo Pharma (ARBP) would acquire seven marketed oncology products, intellectual property and commercial infrastructure from Spectrum Pharma for a consideration of USD300m, which includes an upfront payment of USD160m and a milestone-linked payment of USD140m.**
- **The acquired portfolio is expected to have contributed USD105m to Spectrum in CY18, implying an attractive valuation of EV/sales of ~1.5x (EV based on upfront payment only).**
- **We note that a few of these products are under patent. Also, synergy benefit would accrue as ARBP will use its own platform to market the products, thereby reducing costs. Accordingly, we believe that the acquired portfolio would have margins that are much higher than ARBP's consolidated EBITDA margin.**
- **We raise our FY20/21 EPS estimate by 2%/2.7% to INR60.5/INR63.8 and revise our target price to INR940 (prior: INR920), based on 15x 12M forward earnings, to factor in this acquisition. Maintain Buy.**

Deal to be EPS-accretive from first year: ARBP acquired seven oncology injectable products, intellectual property and commercial infrastructure from Spectrum Pharma for a cash consideration of USD160m. It is also liable to pay USD140m on achieving certain regulatory and sales-based milestones. This will be ARBP's third acquisition in the last six months (one in Europe and two in the US). The acquired products are already commercialized in the US (contributed USD116.2m in CY17 and likely to have contributed ~USD105m in CY18 for Spectrum Pharma). For ARBP, these products are expected to generate sales of ~USD100m for the first 12 months post completion of the deal. The transaction is expected to be EPS accretive from the first year itself. It will also provide ARBP an opportunity to grow its oncology portfolio by launching innovative branded products and using readily available infra for oncology brands.

Bodes well for building specialty portfolio in developed market: Our portfolio analysis indicates four products are under patent**,** which are expiring over FY20-34. Spectrum's 9MCY18 financials indicate that it has been incurring operational losses on business from these products. This is largely due to increased R&D (76% of sales) and selling expenses (84% of sales) for Spectrum. R&D spend has been largely toward its NCE portfolio. Post-acquisition of the commercial portfolio by ARBP, the R&D spend would get eliminated. In addition, selling expenses would reduce considerably as ARBP will use its own marketing platform. Pro forma P&L (Exhibit 1) indicates PAT of USD10m in FY20, which will only increase on the back of an improvement in sales and profitability.

Valuation view: We raise our FY20/21 EPS estimate by 2/2.7% to build in the business contribution from the acquired portfolio. Accordingly, we revise our target price to INR940 (prior: INR920), based on 15x 12M forward earnings. Re-iterate **Buy**.

Stock Info

Bloomberg	ARBP IN
Equity Shares (m)	586
M.Cap.(INRb)/(USDb)	453.7 / 6.4
52-Week Range (INR)	830 / 527
1, 6, 12 Rel. Per (%)	4/33/14
12M Avg Val (INR M)	2111
Free float (%)	48.1

Financials Snapshot (INR b)

Y/E Mar	2018	2019E	2020E
Net Sales	165.0	184.4	259.9
EBITDA	37.9	39.7	58.0
PAT	25.0	25.1	35.5
EPS (INR)	42.7	42.8	60.5
Gr. (%)	8.7	0.2	41.4
BV/Sh (INR)	199.4	237.8	295.8
RoE (%)	23.8	19.6	22.7
RoCE (%)	17.4	15.2	16.0
P/E (x)	18.1	18.1	12.8
P/BV (x)	3.9	3.3	2.6

Shareholding pattern (%)

As On	Dec-18	Sep-18	Dec-17
Promoter	51.9	51.9	51.9
DII	14.4	15.0	15.6
FII	20.1	19.1	18.9
Others	13.6	14.0	13.7

FII Includes depository receipts

Stock Performance (1-year)

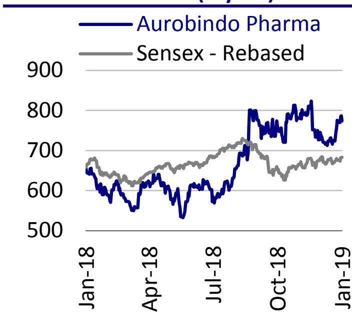

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Exhibit 1: Pro forma P&L indicates addition of USD10m in PAT from deal on 12M basis

Pro forma P&L (USD m)	FY20E
Sales	105.0
Cost of sales	26.4
SGA	48.0
EBITDA	30.6
EBITDA Margin (%)	29.1
Amortization	12.0
Finance cost	4.8
PBT	13.8
tax @ 23%	3.2
PAT	**10.6**
USDINR rate	71.0
PAT (INR m)	**754**
FY19E PAT (INR m)	25067
% Increment over FY19E	**3.0**

Source: MOSL

Exhibit 2: Product details

Brand	Generic Name	Trailing 12M sales (USDm)	Patent expiry	Remarks
Folotyn	Pralatrexate	43.0	2022 / 2025	
Evomela	Melphalan Hydrochloride	29.1	2029 / 2033 / 2034	Being patented, enough scope to increase sales
Beleodaq	Belinostat	11.3	2021 / 2027	
Zevalin	Ibritumomab Tiuxetan	10.0	Expired	Limited scope to increase sales
Marqibo	Vincristine Sulfate	4.3	2020	Being patented, enough scope to increase sales
Fusilev	Levoleucovorin Calcium	2.9	Multiple generic available	Being genercised, limited scope to increase revenue

Source: MOSL, Industry

Exhibit 3: Products and their indications

Brand	Description
Fusilev	It is used for patients with advance metastatic colorectal cancer in combination with 5-fluorouracil in relieving pain without dealing with the cause of the condition
Folotyn	It is used to treat Peripheral T-cell Lymphoma (PTCL) cancer. It is used when other drugs do not work or the cancer returns after treatment with other drugs
Zevalin	It is a three-step treatment used with Rituximab. Two treatment of Rituximab to reduce B-cell in the blood and one treatment of Zevalin. It is used in patients with low grade B-cell that has relapsed during or after treatment with other anticancer drugs
Marqibo	It is an anticancer drug for treatment in adults with Philadelphia chromosome-negative - ALL, or Ph-ALL. Used in second or greater relapse or whose disease has progressed two or more lines of anti-leukemia
Beleodaq	It is a histone deacytelase, or HDAC, inhibitor for the treatment of patients with relapsed or refractory PTCL
Evomela	It is intended for use as a high-dose conditioning treatment prior to autologous stem cell transplant, or ASCT, for patients with MM (a cancer of plasma cells, a type of white blood cell present mainly in the bone marrow that produces antibodies)

Source: MOSL, Industry

Valuation and view:

Long term industry view

US to remain the focus geography

- With intensifying competition in small molecules, faster pace of approvals from the USFDA and reasonable experience in US generics, pharma companies have moved up the value chain toward larger molecules, which are either difficult to develop and/or difficult to manufacture. This would enable companies to have relatively low competition, and thus, better sales and profitability. The phase of superior business from such molecules is subject to lead time for a company compared to peers.
- At the same time, companies with a reasonable base business are facing pricing pressure on account of intensifying competition, which is adversely impacting sales and profitability. Thus, there is ongoing leakage in the base business. Pharma companies are strategizing to have a pipeline of complex generics to not only offset price erosion in the base business but also grow over the medium-to-long term.
- The intensity of pricing pressure was higher in FY18. This, coupled with lower potential approvals, adversely impacted growth in the US business. Regulatory headwinds worsened the situation further.
- We believe that given the strong R&D base, manufacturing capacity and considerable ongoing effort toward successful compliance, Indian pharma companies are poised for better growth, going forward.

ARBP in this backdrop

Unlike peers which reported a sharp decline in US sales in FY18, ARBP delivered 9% YoY growth on the back of its strong launches and diversified portfolio. US sales formed 45% of total sales in FY18. Even on a high base of ~USD1.2b US sales, we expect ARBP to deliver a 37% CAGR over FY18-20, led by the addition of Sandoz portfolio, oncology portfolio and new launches.

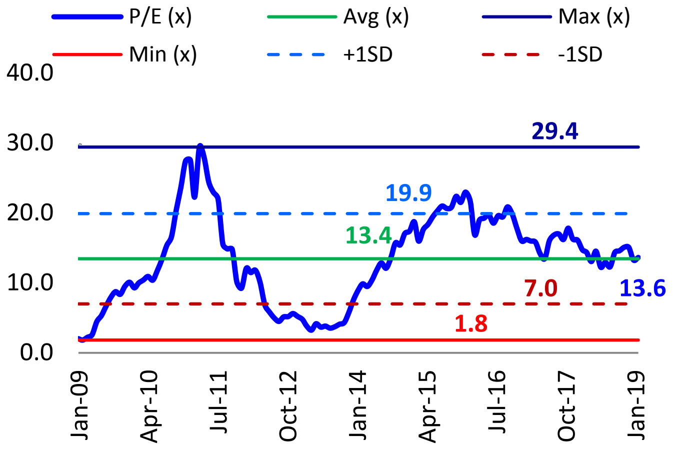
Key catalysts to drive stock's performance over the medium term:

- Strong momentum in ANDA approvals and subsequent launches
- Increased outsourcing from India facility for Europe
- Reduction in financial leverage

Key risks to our investment thesis:

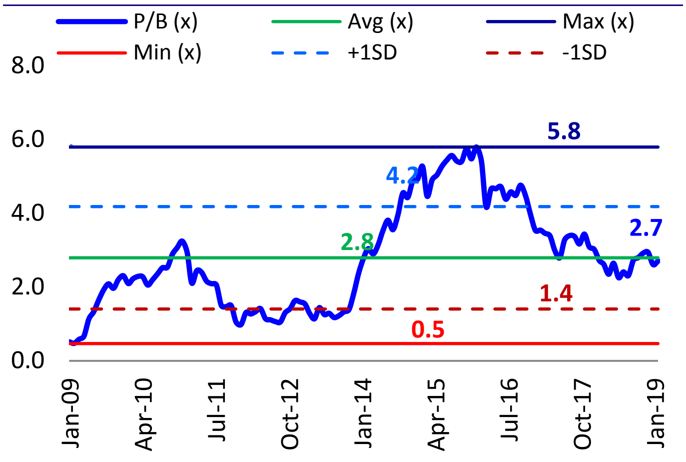
- Regulatory delays affecting key US launches
- Higher-than-expected price erosion in existing and also the Sandoz portfolio
- Lower-than-expected operating leverage in Europe business

Exhibit 4: P/E chart



Source: Company, MOSL

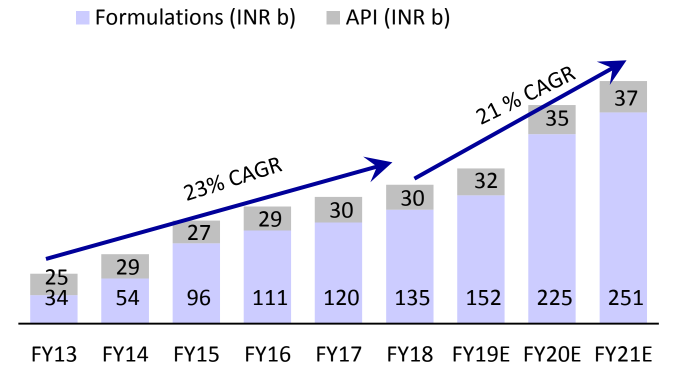
Exhibit 5: P/B chart



Source: Company, MOSL

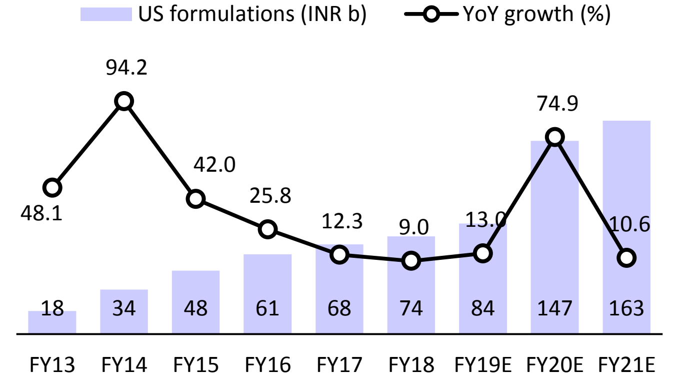
Story in charts

Exhibit 6: Formulation led sales growth



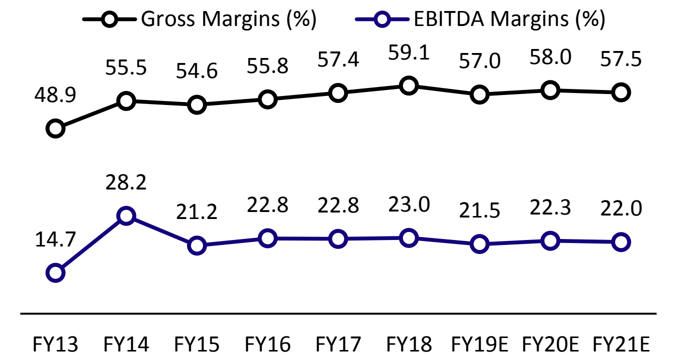
Source: Company, MOSL

Exhibit 7: Recent acquisitions to boost US business



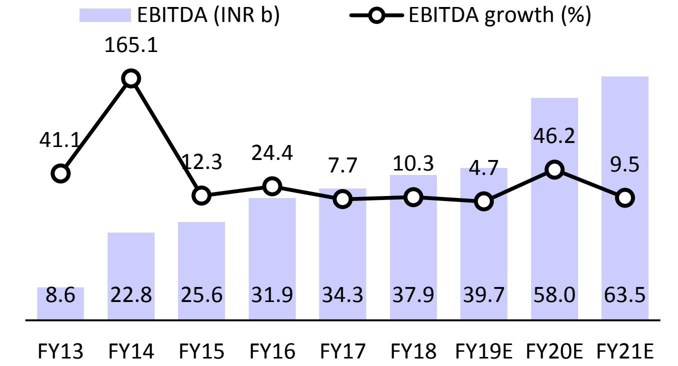
Source: Company, MOSL

Exhibit 8: Margins to remain stable over FY18-21



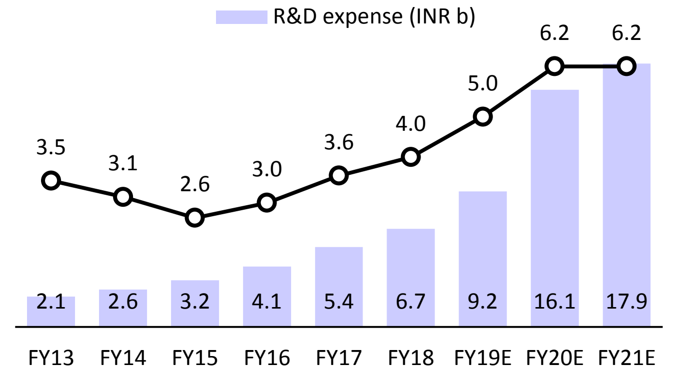
Source: Company, MOSL

Exhibit 9: EBITDA to exhibit 19% CAGR over FY18-21



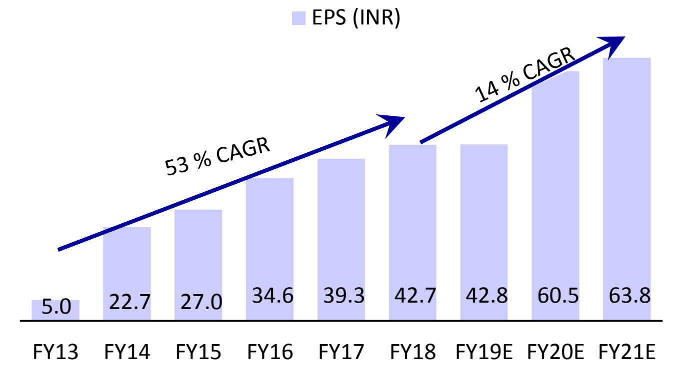
Source: Company, MOSL

Exhibit 10: R&D expense on rise to develop complex molecules



Source: Company, MOSL

Exhibit 11: Expect EPS CAGR of ~14% over FY18-21



Source: Company, MOSL

Financials and Valuations

Consolidated - Income Statement								(INR m)
Y/E March	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19E**	**FY20E**	**FY21E**
Total Income from Operations	**80,998**	**121,205**	**139,553**	**150,897**	**164,998**	**184,439**	**259,943**	**288,632**
Change (%)	38.3	49.6	15.1	8.1	9.3	11.8	40.9	11.0
Total Expenditure	**58,170**	**95,569**	**107,671**	**116,556**	**127,113**	**144,784**	**201,976**	**225,133**
% of Sales	71.8	78.8	77.2	77.2	77.0	78.5	77.7	78.0
EBITDA	**22,828**	**25,636**	**31,882**	**34,341**	**37,885**	**39,654**	**57,967**	**63,499**
Margin (%)	28.2	21.2	22.8	22.8	23.0	21.5	22.3	22.0
Depreciation	3,125	3,326	3,924	4,276	5,580	6,588	9,083	11,427
EBIT	**19,703**	**22,310**	**27,958**	**30,065**	**32,305**	**33,067**	**48,885**	**52,072**
Int. and Finance Charges	1,079	843	927	667	777	1,384	2,619	3,280
Other Income	232	808	701	538	1,020	1,000	500	500
PBT bef. EO Exp.	**18,856**	**22,275**	**27,733**	**29,936**	**32,548**	**32,683**	**46,765**	**49,293**
EO Items	-2,031	-596	-304	621	-168	-1,347	0	0
PBT after EO Exp.	**16,825**	**21,679**	**27,429**	**30,557**	**32,380**	**31,336**	**46,765**	**49,293**
Current Tax	3,635	5,966	7,207	7,596	8,183	7,364	11,364	11,978
Deferred Tax	0	0	0	0	0	0	0	0
Tax Rate (%)	21.6	27.5	26.3	24.9	25.3	23.5	24.3	24.3
Less: Mionrity Interest	-38	-45	-30	-55	-34	-35	-55	-55
Reported PAT	**13,228**	**15,758**	**20,252**	**23,015**	**24,231**	**24,007**	**35,456**	**37,370**
Adjusted PAT	**13,228**	**15,758**	**20,251**	**23,015**	**25,021**	**25,067**	**35,456**	**37,370**
Change (%)	350.1	19.1	28.5	13.6	8.7	0.2	41.4	5.4
Margin (%)	16.3	13.0	14.5	15.3	15.2	13.6	13.6	12.9

Consolidated - Balance Sheet								(INR m)
Y/E March	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19E**	**FY20E**	**FY21E**
Equity Share Capital	583	584	585	586	586	586	586	586
Total Reserves	36,919	50,975	72,288	93,133	116,218	138,760	172,752	208,657
Net Worth	**37,502**	**51,559**	**72,873**	**93,719**	**116,804**	**139,346**	**173,338**	**209,243**
Minority Interest	257	258	26	21	18	19	19	19
Deferred Liabilities	2,054	2,058	-1,823	-1,185	765	780	796	812
Total Loans	36,339	38,636	44,155	30,841	44,825	41,682	112,381	106,254
Capital Employed	**76,151**	**92,511**	**115,230**	**123,397**	**162,413**	**181,827**	**286,533**	**316,328**
Gross Block	41,066	53,821	41,312	53,650	70,719	80,719	123,389	133,389
Less: Accum. Deprn.	14,613	17,405	3,455	7,168	11,843	18,430	27,513	38,940
Net Fixed Assets	**26,453**	**36,416**	**37,856**	**46,482**	**58,876**	**62,289**	**95,876**	**94,449**
Goodwill on Consolidation	764	640	4,063	4,063	8,165	8,165	8,165	8,165
Capital WIP	3,097	4,196	8,359	12,374	13,995	13,995	13,995	13,995
Total Investments	**198**	**198**	**1,230**	**2,459**	**3,115**	**3,115**	**3,115**	**3,115**
Curr. Assets, Loans&Adv.	**64,386**	**87,647**	**105,631**	**95,439**	**125,312**	**137,074**	**214,327**	**249,952**
Inventory	23,675	36,113	40,561	43,305	58,584	68,805	94,717	106,423
Account Receivables	26,366	35,392	46,067	35,042	30,844	34,478	64,096	71,170
Cash and Bank Balance	1,786	4,691	8,003	5,135	12,616	22,791	44,515	61,360
Loans and Advances	12,559	11,451	11,001	11,957	23,268	11,000	11,000	11,000
Curr. Liability & Prov.	**18,747**	**36,587**	**41,909**	**37,420**	**47,051**	**42,812**	**48,946**	**53,350**
Account Payables	13,512	20,511	24,570	24,883	26,274	30,187	36,321	40,725
Other Current Liabilities	3,877	13,650	15,776	11,415	18,209	12,000	12,000	12,000
Provisions	1,358	2,426	1,563	1,123	2,568	625	625	625
Net Current Assets	**45,640**	**51,060**	**63,722**	**58,019**	**78,260**	**94,262**	**165,381**	**196,603**
Appl. of Funds	**76,151**	**92,511**	**115,230**	**123,397**	**162,413**	**181,827**	**286,533**	**316,328**

E: MOSL Estimates

Financials and Valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Basic (INR)								
EPS	**22.7**	**27.0**	**34.6**	**39.3**	**42.7**	**42.8**	**60.5**	**63.8**
Cash EPS	28.1	32.7	41.3	46.6	52.2	54.0	76.0	83.3
BV/Share	64.3	88.3	124.5	160.0	199.4	237.8	295.8	357.1
DPS	1.5	2.3	2.0	2.5	2.5	2.5	2.5	2.5
Payout (%)	6.6	8.3	5.8	6.4	6.0	6.1	4.1	3.9
Valuation (x)								
P/E	34.1	28.7	22.4	19.7	18.1	18.1	12.8	12.1
Cash P/E	27.6	23.7	18.7	16.6	14.8	14.3	10.2	9.3
P/BV	12.0	8.8	6.2	4.8	3.9	3.3	2.6	2.2
EV/Sales	6.0	4.0	3.5	3.2	2.9	2.6	2.0	1.7
EV/EBITDA	21.4	19.0	15.4	14.0	12.8	11.9	9.0	7.9
Dividend Yield (%)	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
FCF per share	-1.4	5.1	-0.5	27.0	-12.3	27.5	-76.7	47.2
Return Ratios (%)								
RoE	41.6	35.4	32.5	27.6	23.8	19.6	22.7	19.5
RoCE	23.3	20.4	20.4	19.0	17.4	15.2	16.0	13.2
RoIC	24.2	20.9	22.8	22.5	20.4	18.4	20.2	17.0
Working Capital Ratios								
Asset Turnover (x)	1.1	1.3	1.2	1.2	1.0	1.0	0.9	0.9
Inventory (Days)	107	109	106	105	130	136	133	135
Debtor (Days)	116	105	120	85	68	68	90	90
Creditor (Days)	137	136	146	141	142	139	121	121
Working Cap. Turnover (Days)	198	140	146	128	145	141	170	171
Leverage Ratio (x)								
Current Ratio	3.4	2.4	2.5	2.6	2.7	3.2	4.4	4.7
Interest Cover Ratio	18	26	30	45	42	24	19	16
Debt/Equity	1.0	0.7	0.6	0.3	0.4	0.3	0.6	0.5

Consolidated - Cash Flow Statement (INR m)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
OP/(Loss) before Tax	19,703	22,310	27,443	30,608	32,305	33,067	48,885	52,072
Depreciation	3,125	3,326	3,924	4,276	5,580	6,588	9,083	11,427
Interest / Dividend recieved	232	808	689	384	1,020	1,000	500	500
Direct Taxes Paid	-3,635	-5,966	-7,326	-7,737	-8,183	-7,364	-11,364	-11,978
(Inc)/Dec in WC	-13,533	-2,515	-10,794	6,110	-12,760	-5,827	-49,396	-14,375
CF from Operations	**5,893**	**17,963**	**13,936**	**33,641**	**17,962**	**27,464**	**-2,293**	**37,645**
Others	-2,031	-596	262	-856	-168	-1,347	0	0
CF from Operating incl EO	**3,863**	**17,367**	**14,198**	**32,786**	**17,795**	**26,117**	**-2,293**	**37,645**
(inc)/dec in FA	-4,656	-14,389	-14,475	-16,942	-25,011	-10,000	-42,670	-10,000
Free Cash Flow	**-793**	**2,978**	**-277**	**15,844**	**-7,217**	**16,117**	**-44,963**	**27,645**
(Pur)/Sale of Investments	-25	0	23	-929	657	0	0	0
CF from Investments	**-4,681**	**-14,388**	**-14,452**	**-17,870**	**-24,355**	**-10,000**	**-42,670**	**-10,000**
Issue of Shares	-910	-386	72	67	318	0	0	0
Inc/(Dec) in Debt	2,131	2,298	6,033	-17,279	13,982	-3,143	70,699	-6,126
Interest Paid	-1,079	-843	-835	-568	-777	-1,384	-2,619	-3,280
Dividend Paid	-875	-1,314	-1,616	-1,372	-1,465	-1,465	-1,465	-1,465
Others	1,253	172	-88	1,369	1,983	50	71	71
CF from Fin. Activity	**520**	**-73**	**3,566**	**-17,784**	**14,042**	**-5,942**	**66,686**	**-10,800**
Inc/Dec of Cash	**-298**	**2,905**	**3,312**	**-2,868**	**7,482**	**10,175**	**21,723**	**16,846**
Opening Balance	2,085	1,786	4,691	8,003	5,135	12,616	22,791	44,515
Closing Balance	**1,786**	**4,691**	**8,003**	**5,134**	**12,616**	**22,791**	**44,515**	**61,360**

NOTES

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst becomes inconsistent with the investment rating legend, the Research Analyst shall within 28 days of the inconsistency, take appropriate measures to make the recommendation consistent with the investment rating legend.

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