

Aurobindo Pharma

Performance Highlights

Y/E march (₹ cr)	3QFY2011	2QFY2011	% chg (qoq)	3QFY2010	% chg (yoy)
Net sales	1,072	1043	2.8	825	30.0
Other income	126	80	56.9	101	25.4
Operating profit	199	184	8.0	152	31.0
Interest	11	19	(40.5)	13	(9.5)
Net profit	189	198	(4.5)	172	10.0

Source: Company, Angel Research

For 3QFY2011, Aurobindo Pharma (APL) posted higher-than-expected results. The only disappointment was on the operating margin front. Top-line growth was mainly led by above-expectation growth in the formulations segment. Net profit (adj. for the extraordinary items and forex gains) grew by 10% yoy. **We have revised our estimates upwards and recommend Buy on the stock.**

Revenue led by US and ARV formulation segments: Net sales grew strongly by 30.0% to ₹1,072, driven by the US and ARV formulation segments. The US formulation segment grew by healthy 48.4% yoy to ₹328cr. The ARV formulation segment posted 63.8% yoy growth to ₹175cr. OPM remained flat at 18.6%, lower than our estimates of 19.3%, impacted by increased employee and other expenses. Adjusted net profit grew by 10% to ₹189cr, higher than our estimates of ₹145cr, driven by revenue growth and higher dossier income.

Outlook and valuation: Considering that the commencement of operations at the Hyderabad SEZ and incremental contribution from the Pfizer deal would boost APL's earnings with better growth visibility going forward, we have revised our estimates upwards to factor in the same. We estimate net sales to log an 18.8% CAGR to ₹4,756cr over FY2010–12 on the back of supply agreements and the US and ARV formulation contracts. We expect APL's recurring earnings (excluding other operating income) to post a 33.2% CAGR over FY2010–12 to ₹539cr on the back of sales growth and OPM expansion. With the revision of estimates, we upgrade the stock to Buy with a revised Target Price of ₹1,415 (₹1,330).

Key financials (Consolidated)

Y/E March (₹cr)	FY2009	FY2010	FY2011E	FY2012E
Net Sales	2,935	3,370	4,007	4,756
% chg	20.8	14.8	18.9	18.7
Net Profit	100	563	585	657
% chg	(58.0)	462.6	3.9	12.3
Recurring Profit	301	454	571	657
% chg	26.3	50.7	25.9	15.0
EPS (₹)	18.6	101.1	103.7	116.4
Adj EPS	56.0	81.5	101.2	116.4
EBITDA Margin (%)	12.7	18.3	18.1	19.2
P/E (x)	20.9	14.4	11.6	10.1
RoE (%)	25.5	29.6	27.2	24.5
RoCE (%)	7.3	12.1	12.6	15.0
P/BV (x)	5.1	3.6	2.8	2.2
EV/Sales (x)	2.9	2.6	2.2	1.8
EV/EBITDA (x)	22.8	14.0	11.9	9.3

Source: Company, Angel Research

BUY

CMP	₹1,173
Target Price	₹1,415

Investment Period	12 months
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Stock Info	
Sector	Pharmaceutical
Market Cap (₹ cr)	6,829
Beta	0.7
52 Week High / Low	1375/786
Avg. Daily Volume	23041
Face Value (₹)	5
BSE Sensex	17,776
Nifty	5,313
Reuters Code	ARBN.BO
Bloomberg Code	ARBP@IN

Shareholding Pattern (%)	
Promoters	54.4
MF / Banks / Indian Fls	9.4
FII / NRIs / OCBs	26.7
Indian Public / Others	9.5

Abs. (%)	3m	1yr	3yr
Sensex	(13.5)	13.2	3.3
APL	(13.7)	27.9	274.1

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Exhibit 1: 3QFY2011 performance

Y/E March (₹ cr)	3QFY2011	2QFY2011	% chg (qoq)	3QFY2010	% chg (yoy)	9MFY2011	9MFY2010	% chg (yoy)
Net sales	1,072	1,043	2.8	825	30.0	2,998	2,477	21.1
Other income	126	80	56.9	101	25.4	249	199	24.9
Total income	1,198	1,123	6.7	925	29.5	3,247	2,676	21.3
Gross profit	1,198	488	145.5	415	188.4	1414	1224	15.5
Gross margins	46.7	46.8		50.4		47.2	49.4	
Operating profit	199	184	8.0	152	31.0	516	471	9.6
OPM (%)	18.6	17.7		18.4		17.2	19.0	
Interest	11	19	(40.5)	13	(9.5)	44	54	(18.5)
Dep & amortisation	43	41	6.5	40	7.4	124	111	12.2
PBT	271	205	32.1	200	35.5	597	506	18.0
Provision for taxation	78	83	(5.7)	55	42.6	190	146	30.2
Reported net profit	192	122	57.8	145	32.8	407	360	13.1
Less : Exceptional items	(4)	(76)		(27)		31	(81)	
MI & share in associates	0.02	0.47	(95.7)	0.12	(83.3)	0.12	0.13	(7.7)
PAT after Exceptional items	189	198	(4.5)	172	10.0	438	441	(0.6)
EPS (₹)	32.4	34.0		31.8		76.4	82.1	

Source: Company, Angel Research

Exhibit 2: Actual v/s Estimate

(₹ cr)	Actual	Estimate	Variation %
Net sales	1072	935	14.6
Other operating income	126	65	94.2
Operating profit	199	180	10.5
Tax	78	44	79.9
Net profit	189	145	30.2

Source: Company, Angel Research

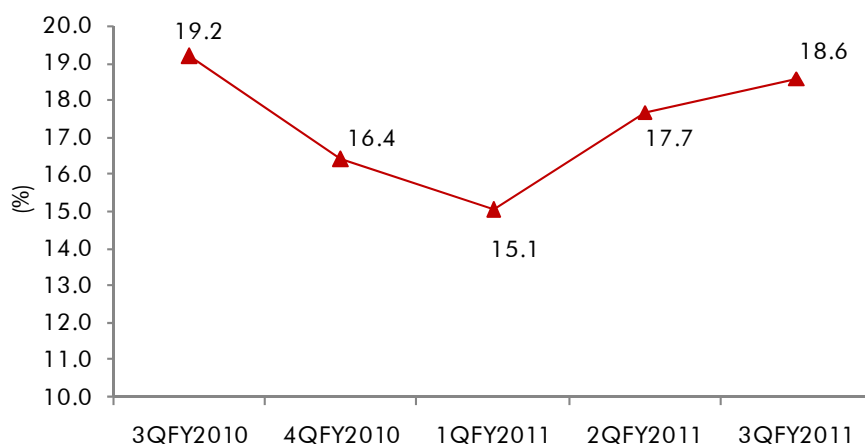
Revenue up 30%, driven by the US and ARV formulation segments: APL reported strong 30% growth in net sales to ₹1,072 (₹825cr), led by the better-than-expected growth in the formulations space, which grew by 53.3% yoy to ₹644cr (₹420cr), majorly driven by growth in the US and ARV formulation segments. The US formulation segment grew by healthy 48.4% yoy to ₹328cr (₹221cr). The company filed 15 ANDAs during the quarter, taking its cumulative filings to 200. The ARV formulation segment reported 63.8% yoy growth to ₹175cr (₹107cr). Further, the Europe and RoW formulation segments grew by 36.2% and 72.3% yoy, respectively. As a result, contribution from the formulations segment to net sales increased to 60% in 3QFY2011 from 51% in 3QFY2010. Overall, growth across the segment was led by contribution through the Hyderabad SEZ, which helped APL overcome capacity constraints. The API segment posted growth of 9.2% yoy to ₹455cr (₹417cr), driven by Ceph's API that grew by 17.5% yoy.

Exhibit 3: Sales break-up

(₹ cr)	3QFY2011	2QFY2011	% chg (qoq)	3QFY2010	% chg (yoy)	9MFY2011	9MFY2010	% chg
Formulations	644	616	4.6	420	53.3	1753	1334	31.4
US	328	296	11.1	221	48.4	840	682	23.2
Europe	68	86	(21.3)	50	36.2	228	152	50.4
ARV	175	172	1.6	107	63.8	493	360	37.1
RoW	73	63	17.4	43	72.3	192	141	36.1
API	455	452	0.7	417	9.2	1318	1197	10.2
SSP	137	160	(14.7)	144	(5.3)	429	467	(8.1)
Cephs	223	206	8.2	190	17.5	615	494	24.4
ARV & others	95	85	11.6	83	15.3	275	236	16.5

Source: Company, Angel Research

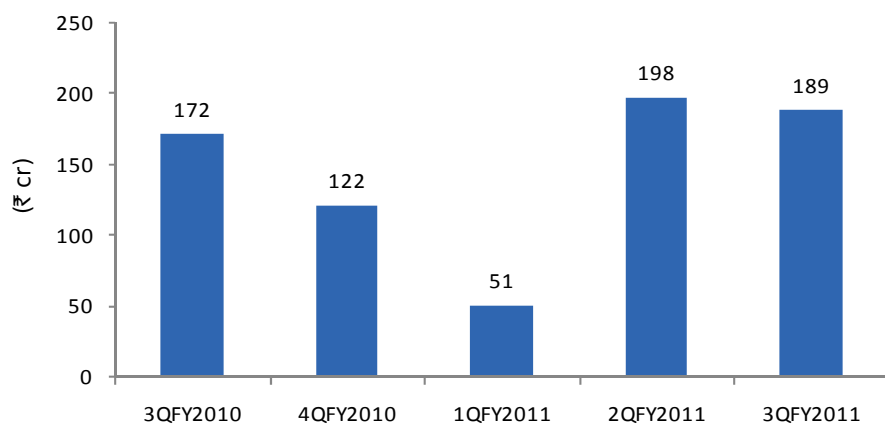
Flat OPM for the quarter: During the quarter, gross margins contracted to 46.7% (50.4%) due to increased material costs. OPM remained flat at 18.6% (18.4%) yoy due to the increase of 20% and 12% in the employee and other expenses to ₹108cr (₹90cr) and ₹194cr (₹173cr), respectively. This was majorly because of the increase in employee strength due to commencement of new facilities.

Exhibit 4: OPM trend


Source: Company, Angel Research

Adjusted net profit up 10%: APL reported adjusted net profit growth of 10% yoy to ₹189cr (₹172cr), driven by revenue growth and higher dossier income. This included forex gain of ₹4.08cr (₹24.81cr) and exceptional item of ₹7.66cr for the quarter. The company recorded other operating income of ₹126cr (₹101cr), up 25.4%, on the back of higher dossier income of ₹120cr (₹91cr) yoy.

Exhibit 5: Net profit trend



Source: Company, Angel Research

Recommendation rationale

- **Supply agreements to drive growth:** On the global filings front (ANDAs and dossiers), APL has increased its filing dramatically from 313 in FY2008 to 1,171 in FY2010, as it proposes to scale up from SSP and Cephs to NPNC products. Further, the company's transformation from being a pure API supplier to becoming a formidable formulations player has increased APL's cost efficiencies, as 90% of its formulation is now backward integrated. Thus, to leverage on its cost efficiency and strong product filings, APL entered into long-term supply agreements with Pfizer (March 2009) and AstraZeneca (September 2010), which provide significant revenue visibility going ahead. APL is also in discussion with other MNCs for more supply agreements.
- **US and ARV formulation segments – The key drivers for base business:** APL's business, excluding the supply agreements, would primarily be driven by the US and ARV segments on the formulation front. APL has been an aggressive filer in the US market, with 169 ANDAs filed and 113 approvals received till FY2010. Amongst peers, APL is the third-largest ANDA filer. The company has aggressively filed ANDAs in the last three years and is now geared to reap benefits, even though most of the filings are for highly competitive products. APL expects to file 15–20 ANDAs in FY2011 and FY2012. Going ahead, during the next three years in the US with US \$70bn going off-patent, one of the highest in history, we believe APL is well placed to tap this opportunity. We expect the base business (ex-Pfizer) to post a 36.0% CAGR over FY2010–12 and contribute US \$268mn by FY2012, with revenue per product increasing to US \$2.6mn from US \$2.3mn in FY2010, as the company moves towards the high revenue-generating NPNC and injectable (SSP and Cephs) products.

APL is one of the largest generic suppliers under the ARV contracts, with 35% market share. The company enjoys high market share as it is fully integrated in all its products apart from having a larger product basket. Overall, we expect the ARV segment to post a 21.4% CAGR over FY2010–12 to ₹730cr, with PEPFAR allocation for generic ARVs expected to increase.

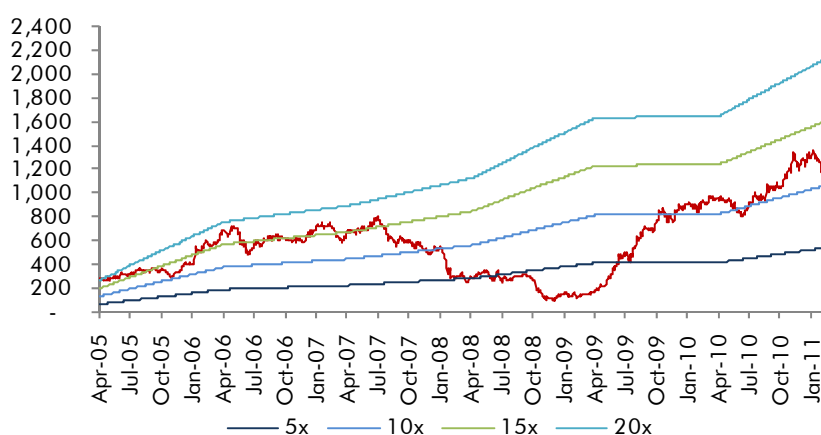
Outlook and valuation

Considering that the commencement of operations at the Hyderabad SEZ and incremental contribution from the Pfizer deal would boost APL's earnings with better growth visibility going forward, we have revised our estimates upwards to factor in the same. We estimate net sales to log an 18.8% CAGR to ₹4,756cr over FY2010–12 on the back of supply agreements and the US and ARV formulation contracts. We expect APL's recurring earnings (excluding other operating income) to post a 33.2% CAGR over FY2010–12 to ₹539cr on the back of sales growth and OPM expansion. **With the revision of estimates, we upgrade the stock to Buy with a revised Target Price of ₹1,415 (₹1,330).**

Exhibit 6: Key assumptions

	Earlier estimates		Revised estimates	
	FY2011E	FY2012E	FY2011E	FY2012E
API sales growth (%)	(1.3)	(0.4)	(1.3)	(0.4)
Formulations sales growth (%)	22.7	32.0	34.3	30.8
Operating margins (%)	18.6	20.4	18.1	19.2
Capex (₹ cr)	288	288	470	280

Source: Company, Angel Research

Exhibit 7: One-year forward PE


Source: Company, Angel Research

Exhibit 8: Recommendation summary

Company	Reco	CMP (₹)	Tgt Price (₹)	Upside %	FY2012E		FY10-12E		FY2012E	
					PE (x)	EV/Sales (x)	EV/EBITDA (x)	CAGR in EPS (%)	RoCE (%)	ROE (%)
Alembic	Buy	65	92	40.8	6.9	0.8	5.2	78.7	20.6	25.7
Aurobindo Pharma	Buy	1,173	1,415	20.6	10.1	1.8	9.3	19.5	15.0	24.5
Aventis*	Neutral	1,850	-	-	21.2	2.9	17.0	13.1	16.9	18.2
Cadila Healthcare	Neutral	752	-	-	19.0	3.1	14.7	26.6	26.0	34.7
Cipla	Buy	317	388	22.3	18.0	3.5	15.7	14.4	17.5	19.5
Dr Reddy's	Neutral	1,533	-	-	19.7	2.5	12.7	99.8	23.8	25.5
Dishman Pharma	Buy	115	230	99.9	6.6	1.3	5.4	10.1	10.1	14.3
GSK Pharma*	Neutral	2,240	-	-	30.3	6.9	19.5	12.0	38.7	28.9
Indoco Remedies	Buy	434	541	24.7	8.0	1.0	5.8	25.7	16.8	18.2
Ipsca labs	Neutral	285	-	-	12.3	1.8	8.5	18.7	23.3	25.1
Lupin	Buy	397	466	17.3	17.1	2.7	14.1	23.2	23.9	31.2
Orchid Chemicals	Neutral	285	-	-	17.2	2.1	10.9	-	7.0	12.7
Ranbaxy*	Neutral	498	-	-	17.7	2.1	11.2	99.7	18.4	19.8
Sun Pharma	Neutral	398	-	-	18.1	4.9	15.0	29.7	21.3	21.4

Source: Company, Angel Research; Note: * December year ending

Profit & loss statement (Consolidated)

Y/E March (₹ cr)	FY2007	FY2008	FY2009	FY2010	FY2011E	FY2012E
Net Sales	2,122	2,430	2,935	3,370	4,007	4,756
Other operating income	13	11	142	206	250	150
Total operating income	2,135	2,441	3,077	3,575	4,257	4,906
% chg	670.9	14.3	26.1	16.2	19.1	15.3
Total Expenditure	1,821	2,089	2,561	2,752	3,283	3,845
Net Raw Materials	1,300	1,412	1,680	1,777	2,008	2,299
Other Mfg costs	206	267	301	338	429	499
Personnel	150	193	244	327	491	621
Other	164	217	336	310	355	426
EBITDA	301	341	374	617	724	911
% chg	70.2	13.2	9.6	65.1	17.3	25.8
(% of Net Sales)	14.2	14.0	12.7	18.3	18.1	19.2
Depreciation & Amortisation	100	100	128	149	185	206
EBIT	202	241	246	468	540	706
% chg	284.4	19.3	2.3	90.0	15.3	30.7
(% of Net Sales)	9.5	9.9	8.4	13.9	13.5	14.8
Interest & other Charges	86	69	93	73	41	47
Other Income	77	110	27	44	36	45
(% of PBT)	37.5	37.6	-	6.9	4.6	5.3
Share in profit of Associates	-	0.0	0.0	-	-	-
Recurring PBT	206	292	323	645	785	854
% chg	170.7	41.8	10.5	100.0	21.6	8.8
Extraordinary Expense/(Inc.)	-	-	201.0	(109.5)	(13.9)	-
PBT (reported)	206	292	122	754	798	854
Tax	4.4	53.6	21.4	191.4	213.0	196.5
(% of PBT)	2.1	18.4	17.6	25.4	26.7	23.0
PAT (reported)	201	238	100	563	585	657
Less: Minority interest (MI)	1	(0)	-	(0)	-	-
PAT after MI (reported)	200	239	100	563	585	657
ADJ. PAT	200	239	301	454	571	657
% chg	292.7	19.1	26.3	50.7	25.9	15.0
(% of Net Sales)	9.4	9.8	3.4	16.7	14.6	13.8
Basic EPS (₹)	37.7	44.4	18.6	101.1	103.7	116.4
Adj EPS (₹)	37.7	44.4	56.0	81.5	101.2	116.4
% chg	409.2	17.8	26.3	45.4	24.2	15.0

Balance sheet (Consolidated)

Y/E March (₹ cr)	FY2007	FY2008	FY2009	FY2010	FY2011E	FY2012E
SOURCES OF FUNDS						
Equity Share Capital	27	27	27	28	28	28
Share Application Money	-	-	-	-	-	-
Reserves & Surplus	859	1,097	1,214	1,801	2,346	2,958
Shareholders' Funds	886	1,124	1,241	1,829	2,375	2,986
Minority Interest	4	3	3	4	4	4
Total Loans	2,078	1,908	2,333	2,155	2,004	1,766
Deferred Tax Liability	68	73	77	91	116	133
Total Liabilities	3,036	3,109	3,654	4,079	4,499	4,890
APPLICATION OF FUNDS						
Gross Block	1,414	1,601	1,869	2,312	2,850	3,280
Less: Acc. Depreciation	316	418	575	697	882	1,087
Net Block	1,099	1,184	1,294	1,615	1,968	2,192
Capital Work-in-Progress	219	278	536	570	502	352
Goodwill	54	53	105	96	96	96
Investments	-	60	-	-	-	-
Current Assets	2,135	2,059	2,289	2,506	2,852	3,399
Cash	582	283	128	73	(24)	(94)
Loans & Advances	272	316	394	375	585	668
Other	1,281	1,460	1,767	2,058	2,290	2,825
Current liabilities	471	526	570	708	919	1,150
Net Current Assets	1,664	1,534	1,719	1,798	1,932	2,249
Mis. Exp. not written off	-	-	-	-	-	-
Total Assets	3,036	3,109	3,654	4,079	4,499	4,890

Cash flow statement (Consolidated)

Y/E March (₹ cr)	FY2007	FY2008	FY2009	FY2010	FY2011E	FY2012E
Profit before tax	206	292	73	752	785	854
Depreciation	100	100	128	149	185	206
(Inc)/Dec in Working Capital	(267)	(91)	(334)	(261)	(231)	(387)
Less: Other income	(83)	(49)	(180)	44	36	45
Direct taxes paid	(23)	(46)	(30)	(153)	(188)	(179)
Cash Flow from Operations	99	305	16	443	514	448
(Inc.)/Dec.in Fixed Assets	(345)	(244)	(479)	(400)	(470)	(280)
(Inc.)/Dec. in Investments	(205)	113	48	(9)	-	-
Other income	(83)	(49)	(180)	44	36	45
Cash Flow from Investing	(633)	(181)	(611)	(365)	(434)	(235)
Issue of Equity	3	2	-	5	-	-
Inc./ (Dec.) in loans	791	(141)	287	(1)	(137)	(238)
Dividend Paid (Incl. Tax)	(9)	(16)	(39)	(29)	(40)	(46)
Others	130	(268)	193	(109)	-	-
Cash Flow from Financing	915	(423)	440	(132)	(176)	(284)
Inc./ (Dec.) in Cash	381	(300)	(155)	(54)	(97)	(70)
Opening Cash balances	202	582	283	128	73	(23)
Closing Cash balances	582	283	128	73	(23)	(94)

Key ratios

Y/E March	FY2007	FY2008	FY2009	FY2010	FY2011E	FY2012E
Valuation Ratio (x)						
P/E (on FDEPS)	31.1	26.4	20.9	14.4	11.6	10.1
P/CEPS	20.9	18.6	27.7	9.2	8.6	7.7
P/BV	7.1	5.6	5.1	3.6	2.8	2.2
Dividend yield (%)	0.2	0.3	0.4	0.4	0.5	0.6
EV/Sales	3.7	3.3	2.9	2.6	2.2	1.8
EV/EBITDA	25.7	23.2	22.8	14.0	11.9	9.3
EV / Total Assets	2.6	2.6	2.3	2.1	1.9	1.7
Per Share Data (₹)						
EPS (Basic)	37.7	44.4	18.6	101.1	103.7	116.4
EPS (fully diluted)	37.7	44.4	56.0	81.5	101.2	116.4
Cash EPS	56.2	63.0	42.4	127.9	136.4	152.8
DPS	2.5	3.3	4.5	5.0	6.1	7.0
Book Value	166.1	209.1	230.9	328.3	420.6	528.9
Dupont Analysis						
EBIT margin	9.5	9.9	8.4	13.9	13.5	14.8
Tax retention ratio	97.9	81.6	82.4	74.6	73.3	77.0
Asset turnover (x)	1.0	0.9	1.0	0.9	1.0	1.0
ROIC (Post-tax)	8.9	7.5	6.7	9.8	9.9	11.8
Cost of Debt (Post Tax)	4.9	2.8	3.6	2.4	1.5	1.9
Leverage (x)	0.9	1.6	1.6	1.5	1.0	0.7
Operating ROE	12.7	14.7	11.7	20.6	18.2	19.1
Returns (%)						
ROCE (Pre-tax)	7.7	7.8	7.3	12.1	12.6	15.0
Angel ROIC (Pre-tax)	10.1	10.3	9.2	15.0	14.9	16.7
ROE	23.5	23.7	25.5	29.6	27.2	24.5
Turnover ratios (x)						
Asset Turnover (Gross Block)	1.6	1.6	1.8	1.7	1.6	1.6
Inventory / Sales (days)	96	108	99	101	97	98
Receivables (days)	103	97	92	94	90	92
Payables (days)	81	78	70	74	67	66
WC cycle (ex-cash) (days)	203	174	169	169	158	160
Solvency ratios (x)						
Net debt to equity	1.7	1.4	1.8	1.1	0.9	0.6
Net debt to EBITDA	5.0	4.8	5.9	3.4	2.8	2.0
Interest Coverage (EBIT / Interest)	2.3	3.5	2.6	6.4	13.1	15.0

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Disclosure of Interest Statement

	Aurobindo Pharma
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹ 1 lakh for Angel, its Group companies and Directors.

Ratings (Returns):

Buy (> 15%)	Accumulate (5% to 15%)	Neutral (-5 to 5%)
Reduce (-5% to 15%)	Sell (< -15%)	