VALUE PICKS

EQUITY RESEARCH REPORT

AUROBINDO PHARMA LTD	BSE CODE: 524804 NSE CODE: AUROPHARMA
Sector: Pharmaceuticals	CMP: Rs. 187.30 (27/01/2013)
Market Cap: 54543.9 (Millions)	Target Price: Rs. 275
Date: Jan 27, 2013	Time Period: 12 – 18 months

Saral Gyan
Investors guide providing insight to equity market

Saral Gyan Capital Services
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An Independent Equity Research Firm

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1. Company Background

Founded in 1986 by Mr. P.V. Ramaprasad Reddy, Mr. K. Nityananda Reddy and a small group of highly committed professionals, Aurobindo Pharma was born off a vision. The company commenced operations in 1988-89 with a single unit manufacturing Semi-Synthetic Penicillin (SSP) at Pondicherry.

Aurobindo Pharma became a public company in 1992 and listed its shares in the Indian stock exchanges in 1995. In addition to being the market leader in Semi-Synthetic Penicillins, it has a presence in key therapeutic segments such as neurosciences, cardiovascular, anti-retrovirals, anti-diabetics, gastroenterology and cephalosporins, among others.

Through cost effective manufacturing capabilities and a few loyal customers, the company entered the high margin specialty generic formulations segment. In less than a decade Aurobindo Pharma today has evolved into a knowledge driven company manufacturing active pharmaceutical ingredients and formulation products. It is R&D focused and has a multi-product portfolio with manufacturing facilities in several countries.

The formulation business is systematically organized with a divisional structure, and has a focused team for key international markets. Leveraging on its large manufacturing infrastructure for APIs and formulations, wide and diversified basket of products and confidence of its customers, it aims to achieve USD 2 billion revenues by 2015-16. Aurobindo's nine units for APIs / intermediates and seven units for formulations are designed to meet the requirements of both advanced as well as emerging market opportunities.

A well integrated pharma company, Aurobindo Pharma features among the top 10 companies in India in terms of consolidated revenues. Aurobindo exports to over 125 countries across the globe with more than 70% of its revenues derived out of international operations. Our customers include premium multi-national companies.. With multiple facilities approved by leading regulatory agencies such as USFDA, EU GMP, UK MHRA, South Africa-MCC, Health Canada and Brazil ANVISA, Aurobindo makes use of in-house R&D for rapid filing of patents, Drug Master Files (DMFs), Abbreviated New Drug Applications (ANDAs) and formulation dossiers across the world. Aurobindo Pharma is among the largest filers of DMFs and ANDAs from India.

Research & Development

One of the largest R&D facilities in India, Aurobindo Pharma has three research centres spread over 16000 square meters. The company employs over 650 scientists (including 35 PhDs). In-house expertise in product development ensures a quick turnaround time in areas such as:

- Project / product identification
- Literature evaluation / patent study
- API process development
- Formulation development
- Pilot BA / BE
- Exhibiting batches for dossier submission
- Stability studies for global requirements
- Dossier submission

Aurobindo is also associated with UNO for development of ARVs (Pediatric and fixed dose combinations). Apart from NDA filings, the company contributes to over 2300 dossier filings worldwide. It has established capabilities in Contract Research and Manufacturing Services (CRAMS) and regularly supplies impurity standards to the United States Pharmacopeial Convention (USP).

Core Strength

Scales and Leadership

- Large manufacturing facilities approved by leading regulatory bodies
- Large diversified product portfolio
- Large R&D facility in India for formulations and active ingredients

Operational Excellence

- Vertical integration
- Proven regulatory expertise
- Technology and know-how for specialty formulations

Service Delivery

- Global marketing network
- Customer centric approach and relationship oriented marketing
- Speed and effectiveness in execution with TQA

Business Units

1. Formulations

Aurobindo Pharma Ltd. is a vertically integrated pharmaceutical company that delivers innovative solutions. From discovery to development to commercialization, our growth is aided by cost-effective drug development and substantial manufacturing.

Leveraging India's globally competitive cost base and talented team of scientists, we have successfully launched a range of affordable products which are accessible across the globe

We have eight state-of-the-art formulation manufacturing facilities located in India, USA and Brazil. Our facilities have received accreditations from the following regulatory bodies:

- US FDA (United States Food and Drug Administration)
- UK's MHRA (United Kingdom's Medicines and Health products Regulatory Agency)
- TGA Australia (Therapeutic Goods Administration)
- MCC South Africa (Medicines Control Council)
- ANVISA Brazil (National Health Surveillance Agency)
- Health Canada and
- GCC DR (Gulf Central Committee for Drug Registration

2. API

Aurobindo is one of the top API manufacturing companies in the world and also one of the very few pharmaceutical companies that are vertically integrated with a presence in the API and Formulations segment. This makes Aurobindo a truly formidable, fully integrated global pharmaceutical company.

By maintaining cost leadership and competitiveness in various therapeutic domains, Aurobindo's API business has ensured the profitability and growth of the company's Formulation business in addition to being a top API supplier globally.

We are one among the very few players present across betalactams and non-betalactams. In betalactams we offer both sterile and non-sterile penicillin and cephalosporins along with penams. This was achieved by focusing on improving operational efficiencies with a careful and meticulous product selection strategy based on real time market requirements. By maintaining cost leadership, the flexibility to switch manufacturing operations and, the competitiveness in various therapeutic domains, Aurobindo's API business has been in the top league, globally

Our API business is supported by technologically advanced API research and development infrastructure, which develops new products and is engaged upto the delivery of products to the market.

The API research division is housed in a sprawling 15-acre campus with a built up area of over five hundred thousand square feet which houses both chemical and analytical research along with a kilo lab. With experience of commercializing over 200 APIs, the research team is completely attuned to our growth aspirations. Committed to quality, safety and the environment, five of our manufacturing facilities have been inspected and approved by the US FDA, UK MHRA, TGA Australia, ANVISA and other reputed regulatory agencies.

Manufacturing units

Particulars	Products	Segment	Approvals	Comment
Unit 1	API	CVS, CNS, anti-allergies, cephalosporin (non-sterile)	USFDA, UKMHRA, TGA (Australia), ANVISA (Brazil), WHO	
Unit III	Formulations	Multi-purpose non-betalectum	USFDA, INFARED, TGA (Australia), Health Canada, MCC (SA), ANVISA (Brazil)	Was under warning letter since March 2012, now cleared as few approvals have come from this facility
Unit IV	Formulations	Injectable (non-cephalosporins and non-semi-synthetic penicillins)	ANVISA (Brazil)	New unit, expected to be cleared by USFDA by end of December 2012; 18 products filed from this site, approvals to start shortly
Unit V	API	Semi-synthetic penicillins	USFDA, MHRA (UK), EDQM, TGA (Australia), ANVISA (Brazil)	
Unit VI A	API	Cephalosporins (sterile)	MHRA (UK), EDQM, TGA (Australia), ANVISA (Brazil), Health Canada, MCC (SA)	Inspection by USFDA is over; expect clearance by end of December 2012
Unit VI B	Formulations	Cephalosporins (sterile and non-sterile)	FIMEA (Finland), TGA (Australia), ANVISA (Brazil), Health Canada, MCC (SA)	
Unit VII	Formulations	Multi-purpose non-betalactum	USFDA, INFARED, MCC (SA), ANVISA (Brazil)	
Unit VIII	API	ARVs, CVS, CNS	USFDA, MHRA (UK), TGA (Australia), ANVISA, (Brazil), KFDA, WHO	
Unit XI	API	ARVs, CVS, CNS	USFDA, MHRA (UK), TGA (Australia), KFDA, WHO	
Unit XII	Formulations	Semi-synthetic penicillins (sterile and non-sterile)	USFDA, TGA (Australia), MCC (SA), ANVISA (Brazil), FIMEA (Finland)	
	Bio-equivalence (inspected)		USFDA, MHRA (UK), AFSSAPS (France), ANVISA (Brazil), MCC (SA)	

Our state-of-the-art manufacturing plants ensure that we deliver quality and scale. We have successfully integrated our capabilities and capacities to deliver a wide product portfolio that caters to the needs of diverse markets. Aurobindo operates dedicated facilities for categories from intermediates to oral and sterile betalactams. There are multiple site filings to mitigate the supply risk and to ensure business continuity. Aurobindo API plants are equipped with particle size modifications systems to supply compacted and micronized materials.

Manufacturing is backed by warehousing systems that offer ambient control room temperature (CRT) and cold rooms. API plants are equipped by site dedicated quality control laboratories. We practice DIMAP, FEMA methodologies as part of our QMS.

We offer the complete bandwidth of products in Penicillins, Cephalosporins, Anti-retroviral, Anti-infectives and other non betalactams. We also offer sterile and non sterile anti-biotics.

2. Recent Development

US formulation business remains the key performance trigger

Management has guided for 15-20% growth in top-line on back of 25 new launches in US out of which 3 will be in the controlled substances space. The company has 162 ANDA approvals from USFDA, including 136 final approvals and 26 tentative Approvals. Management has guided for 15 new launches & 4 approvals during H1FY13. Revenues in US business will further ramp-up on back of approval on Unit IV (18 filings) and Unit VI (25 filed, 16 approved).

Driving revenue growth with increase in operating margins

Aurobindo Pharma plans to go aggressive by filing 25 ANDAs per year with a focus on products with less competition. Moreover, it has recently started reducing its dependence on partners which fetches licencing income for the company. In fact, the dependence on foreign partners had resulted in an unpredictable demand pattern for the company and its profit margins had also been lower. Going on its own will help Aurobindo Pharma to have not only a predictable revenue stream but also a better operating profit margin (OPM). However, the ramp-up will take some time and initially it may extend the working capital cycle. We expect the US business to grow at 20% each in FY2013 and FY2014.

3. Financial Performance

Aurobindo Pharma reports net profit of Rs 238.01 crore in the September 2012 quarter

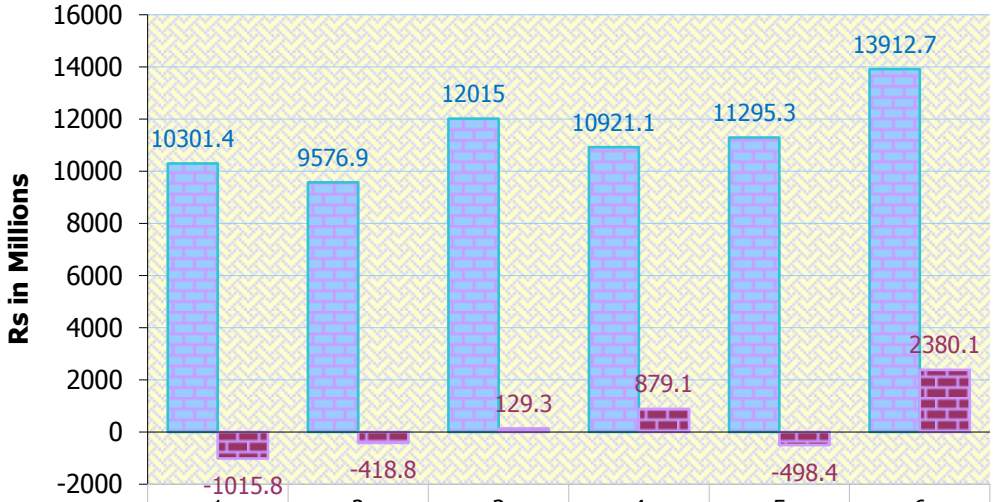
Net profit of Aurobindo Pharma reported to Rs 238.01 crore in the quarter ended September 2012 as against net loss of Rs 41.88 crore during the previous quarter ended September 2011. Sales rose 47.03% to Rs 1372.48 crore in the quarter ended September 2012 as against Rs 933.44 crore during the previous quarter ended September 2011.

Aurobindo Pharma reports net loss of Rs 49.84 crore in June Quarter

On standalone basis, the company has reported a net loss of Rs 49.84 crore for the quarter ended June 30, 2012 against net loss of Rs 101.58 crore for the corresponding period last fiscal. However, total income increased by 9.07% at Rs 1130.61 crore during the quarter under review from Rs 1036.60 crore in the year-ago period.

On consolidated basis, the company has reported a net loss of Rs 128.91 crore for the quarter ended June 30, 2012 against net loss of Rs 122.80 crore for the corresponding period last fiscal. However, total income increased by 12.22% at Rs 1216.63 crore during the quarter under review from Rs 1084.16 crore in the year-ago period

Last 6 Quarters Net Sales & Profit



	1	2	3	4	5	6
Net Sales	10301.4	9576.9	12015	10921.1	11295.3	13912.7
Net Profit	-1015.8	-418.8	129.3	879.1	-498.4	2380.1
	Jun 11	Sep 11	Dec 11	Mar 12	Jun 12	Sep 12

Current & Expected Earnings (In Millions):

QUARTERLY RESULTS	Dec '11	Mar '12	Jun '12	Sep '12	Dec'12E	Mar'13E
Net Sales	12015	10921.1	11295.3	13912.7	14313.4	15523.4
Total Expenditure	11323	9884.6	11374.2	11540.5	12012.2	12452.5
PBIDT (Excl OI)	**692**	**1036.5**	**-78.9**	**2372.2**	**2301.2**	**3070.9**
Other Income	16.8	1044.2	10.8	1310.7	1123.1	1245.3
Operating Profit	708.8	2080.7	-68.1	3682.9	3424.3	4316.2
Interest	245.1	325	303	299.9	287.1	373.1
Exceptional Items	0	0	0	0	0	0
PBDT	463.7	1755.7	-371.1	3383	3137.2	3943.1
Depreciation	360.1	383.8	410.4	421.3	435.4	461.3
Profit Before Tax	103.6	1371.9	-781.5	2961.7	2701.8	3481.8
Tax	-25.7	492.8	-283.1	581.6	574.3	643.3
Provisions and contingencies	0	0	0	0	0	0
Profit After Tax	129.3	879.1	-498.4	2380.1	2127.5	2838.5
Extraordinary Items	0	0	0	0	0	0
Prior Period Expenses	0	0	0	0	0	0
Other Adjustments	0	0	0	0	0	0
Net Profit	**129.3**	**879.1**	**-498.4**	**2380.1**	**2127.5**	**2838.5**
Equity Capital	291.1	291.1	291.1	291.1	291.1	291.1
Face Value (IN RS)	1	1	1	1	1	1
Reserves						
Calculated EPS	**0.44**	**3.02**	**-1.71**	**8.18**	**7.31**	**9.75**
Calculated EPS (Annualised)	1.78	12.08	-6.85	32.7	29.23	39.00
No of Public Share Holdings	131794307	131708307	131708307	131708307	--	--
% of Public Share Holdings	45.27	45.24	45.24	45.24	--	--

For 2QFY2013, Aurobindo Pharmaceuticals Ltd (APL) posted results above expectations on the top-line as well as the net profit front. The OPM came mainly in line with expectations (15.1%) at 15.6%. However, on back of lower taxation and higher OPM, the company posted higher than expected adj. net profits, which came in at Rs 136 crore.

Gross margin came in at 48.9% (43.0% in 2QFY2013), on back of a favourable product mix, thus impacting the OPM which came in at 15.6% vs 8.6%. This led the company to post an adj. net profit of Rs 136 crore.

The commencement of operations at the Hyderabad SEZ and incremental contribution from the Pfizer deal would boost APL's earnings and provide better growth visibility going forward.

4. Investment Rationale

i) Supply agreements to drive growth:
On the global filings front (ANDAs and dossiers), Aurobindo Pharma Ltd has increased its filing dramatically from 313 in FY2008 to 1,647 in FY2012, as it proposes to scale up from SSP and Cephs to NPNC products.

ii) Transformation from API supplier to a formidable formulations player:
Aurobindo Pharma Ltd has increased its cost efficiencies, as 90% of its formulation is now backward integrated. Thus, to leverage on its cost efficiency and strong product filings, APL has entered into long-term supply agreements with Pfizer (March 2009) and Astra Zeneca (September 2010), which provide significant revenue visibility going ahead. APL is also in discussion with other MNCs for more supply agreements.

iii) Key Business Drivers - US and ARV formulation segment
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 239 ANDAs filed until FY2012. 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 every year going forward.

iv) Margins and cash flows to improve going ahead:
With the expected increase in the export-led business post-resolution of the USFDA issues, the favourable tilt in the revenue mix is likely to boost the margins, resulting in a relatively much better growth in earnings as compared with revenues. The company has also been able to successfully redeem its outstanding foreign currency convertible bonds (FCCBs) through external commercial borrowings in FY2012 and is well funded to meet its commitment of repaying its long-term debt (close to $80 million) in the current fiscal. Though the net debt level continues to be high (a debt-equity ratio at 1.1x) but we expect the improving operating performance and the consequent strong internal generation of cash flows to ease the stress on the balance sheet.

v) Change in strategy to rejuvenate growth:
The company envisages several changes in its business strategy to rejuvenate growth. These include (a) reduction of the dependence on partners in the developed markets (the USA and Europe) and focus on self-driven businesses (through wholly owned subsidiaries) to ensure predictable growth; (b) focus on niche segments like controlled substances in the USA; (c) focus on cost control and margin expansion; (d) investments in upgrading manufacturing units to avoid USFDA action in future; and (e) aggressive product filings in different countries.

5. Peer Group Comparison

PEER GROUP	AUROBINDO PHARMA	DR REDDY LAB	IPCA LABS	TORRENT PHARMA
CMP	187.30	1942.55	501.15	742.20
52 W H/L	204.90/99.65	1968.6/1528	537.05/283	761.00/536.25
Market Cap	54543.87	329915.84	63220.25	62798.55
Results (in Million)	Sep-12	Sep-12	Sep-12	Sep-12
Sales	13912.70	21085.50	7712.90	6889.20
PAT	2380.10	3630.30	1250.90	1621.10
Equity	291.10	849.20	252.30	423.10
EPS	9.92	50.67	24.46	53.33
P/E	18.87	38.34	20.49	13.92

6. Risk & Concerns

High debt level and forex rate are key concerns: By the end of Q2FY2013, the company had Rs 3,300 crore ($620 million) of net debts (cash in hand Rs 115 crore) ascompared with Rs 3,025 crore by the end of FY2012. The debt level has risen mainly due to the depreciation in the rupee against the dollar. A substantial portion of the company's debts (nearly 90%) is denominated in dollars and therefore the forex rate plays an important role for the company. The company keeps its foreign assets and liabilities open (natural hedge) and that leads to MTM provisions. In Q1FY2013 Aurobindo Pharma provided an MTM loss of Rs 206 crore, which substantially represented MTM on debts. However, it provided gains of Rs118 crore in Q2FY2013. The company needs to repay long-term debts of $80 million in FY2013 and for that matter the forex rate would be crucial.

Cash flow to remain under pressure in FY2013: During FY2012, the company witnessed pressure on cash flows mainly due to the repayment of FCCBs and a weakeroperating performance. Despite the reduced working capital cycle the net changes in cash plunged to negative in FY2012. Though we expect a better operating performance in FY2013, but the cash flows would remain under pressure due to the repayment of foreign debts ($80 million) and the expansion of the working capital cycle, due to a higher proportion of revenues from expanded operations in the USA and Europe. However, the cash flows should improve in FY2014 which would also help retire part of the debts during the year.

Risk related to CBI investigation against promoter of Aurobindo Pharma: Company's key promoters and managerial persons are being implicated in a graft case running against Jagan Reddy (son of former chief minister of Andhra Pradesh, Mr YSR Reddy). Since the issue is political in nature, any negative development on this front may cause a financial loss to the company.

7. Saral Gyan Recommendation

- Aurobindo Pharma Ltd is one of the largest generic suppliers under ARV contracts, with a 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. Among peers, it is trading at a 22% discount to Ipca Laboratories and a 17% discount to Torrent Pharmaceuticals, though it has a stronger product pipeline. This leaves scope for further re-rating of the stock.

- Aurobindo Pharma Ltd aims to maintain 25 ANDA filings per year, which should see the product pipeline strengthening further. Its focus on margin would also help it strengthen the bottom line. Moreover, the USFDA clearance would be an immediate booster for the company.

- Company has expanded its product portfolio to cover formulations for cardiovascular (CVS) diseases, central nervous system (CNS) related diseases, anti-retrovirals, antibiotics, gastrointestinals, anti-diabetics and antiallergics. Besides, it has expanded its presence in the contract research and manufacturing services segment through US-based manufacturing units operating under the banner of AuroSource. Apart from having 11 manufacturing units in India, it has expanded its manufacturing base to the USA and Brazil.

- As per our estimates, APL can deliver total sales of Rs 5504 crores and PAT of Rs 685 crores, resulting in EPS of Rs 23.5 in FY 2012-13. This translates to an expected PE multiple of 8 times based on FY 2012-13 earnings. Company has paid regular dividend to share holders and dividend yield at CMP is 0.5.

- On equity of Rs. 29.11 crores the estimated annualized EPS for FY 12-13 works out to Rs. 23.5 and the book value per share is Rs. 92.08. At a CMP of Rs. 187.30, price to book value is 2. Currently, the scrip is trading at 8X FY 2012-13 and 6.5X FY 2013-14 estimated earnings which make Aurobindo Pharma an attractive bet at CMP.

Saral Gyan Team recommends "BUY" for Aurobindo Pharma Ltd at current market price of 187.30 for a target of Rs. 275 over a period of 12-18 months.

Buying Strategy:

- 60% at current market price of 187.30
- 40% at price range of 170-180 (In case of correction in stock price in near term)

8. Disclaimer

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