Aurobindo Pharma Ltd.

November 14th, 2014

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Aurobindo Pharma Ltd (Auro Pharma), headquartered at Hyderabad, India, was founded in 1986. The company's operations revolves around developing, manufacturing and marketing active pharmaceutical ingredients (APIs), intermediates and generic formulations. With its manufacturing facilities approved by several leading regulatory agencies like USFDA, UK MHRA, WHO, Health Canada, MCC South Africa, ANVISA Brazil; the company's robust product portfolio is spread over 6 major therapeutic/product areas encompassing Antibiotics, Anti-Retrovirals, CVS, CNS, Gastroenterologicals, and Anti-Allergics. The company markets these products globally, in over 100 countries.

Investment Rationale

Showcased strong numbers in Q2FY15: Auro Pharma's second quarter earnings remained strong with US formulations stealing the show. The company's consolidated total revenue grew by 50.5% YoY to ₹28,812.2 mn on the back of 60.7% YoY growth in revenue from the US formulations. A massive rise in revenue from the European formulations by 349.3% YoY, further provided a push to the revenues. In line with this, EBITDA grew by 45.4% YoY to ₹6,372.1 mn in Q2FY15, while, the EBITDA margin contracted by 79bps YoY to 22.1% impacted by an increase in staff cost and other expenses partly due to integration of the recently acquired Actavis operations. Net profit of the company also grew by 58.4% YoY to ₹3,721.8 mn, during the quarter.

We remain positive for FY15 on the back of sustained growth in the US business, expectations for higher contribution in revenue from Europe in the coming quarters, healthy regulatory filings and the recent acquisitions. We estimate ~41% and ~33.7% YoY growth in revenue in FY15E and FY16E, respectively, while the profit is expected to grow by ~12.2% and 34.8% YoY in FY15E and FY16E, respectively.

Diversified portfolio strategy augurs well for Auro Pharma: The strategy to leverage on its strong product filings capability is likely to result in strong earnings growth in FY15. During Q2FY15, Auro Pharma's cumulative filings for ANDAs stood at 378 (2 in Q2FY15) for the US business, while for DMFs, the cumulative filing stood at 183 (2 in Q2FY15). As on 30th September 2014, the company has 94 formulations dossiers filing in other key advanced markets and 6 patent fillings on a consolidated basis. With such a strong product filing base, the company is well positioned among its peers.

Debt no more a fear factor: The debt kept on piling over the last few years as the capacity built-up was in full flow. The company's total debt has reduced substantially over a period of time. The total debt of the company grew by ~46.3% in FY12 to ₹25,728 mn as against a growth of ~7.4% in FY14 to ₹36,339 mn. This was mainly on account of consistent and incremental cash flows from the US business. While the D/E ratio improved from 1.1x to 1.0x, the debt/EBITDA has improved from 4.6x to 1.7x during FY12-14.

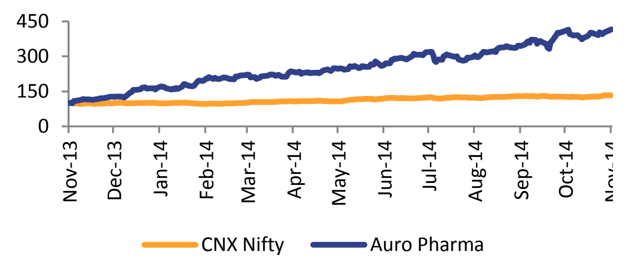
Market Data

Rating	**BUY**
CMP (₹)	1,120.9
Target (₹)	**1,340**
Potential Upside	~20%
Duration	Long Term
Face Value (₹)	1.0
52 week H/L (₹)	1,133.5/261.0
Adj. all time High (₹)	1,335.0
Decline from 52WH (%)	1.1
Rise from 52WL (%)	329.4
Beta	0.6
Mkt. Cap (₹bn)	326.8
Enterprise Value (₹bn)	361.6

Fiscal Year Ended

Y/E	FY13A	FY14A	FY15E	FY16E
Revenue (₹bn)	58.6	81.0	114.2	152.7
EBITDA (₹bn)	8.6	21.3	24.6	31.6
Net Profit (₹bn)	2.9	11.7	13.2	17.7
EPS (₹)	10.1	40.2	45.1	60.8
P/E (x)	111.1	27.9	24.8	18.4
P/BV (x)	12.5	8.7	6.6	5.0
EV/EBITDA (x)	41.7	17.0	15.1	12.2
ROCE (%)	16.7	35.0	31.8	32.4
ROE (%)	11.3	31.3	26.7	27.0

One year Price Chart



Shareholding Pattern	Sep'14	Jun'14	Diff.
Promoters	54.1	54.3	(0.2)
FII	27.7	27.6	0.1
DII	8.0	7.7	0.3
Others	10.2	10.4	(0.2)

Auro Pharma - one of the world's top 5 manufacturers of Semi-Synthetic Penicillins

Auro Pharma's product portfolio is spread across six major product areas, namely, antibiotics, anti-retrovirals, cardiovascular (CVS) products, central nervous system (CNS) products, astroenterologicals, and anti-allergics.

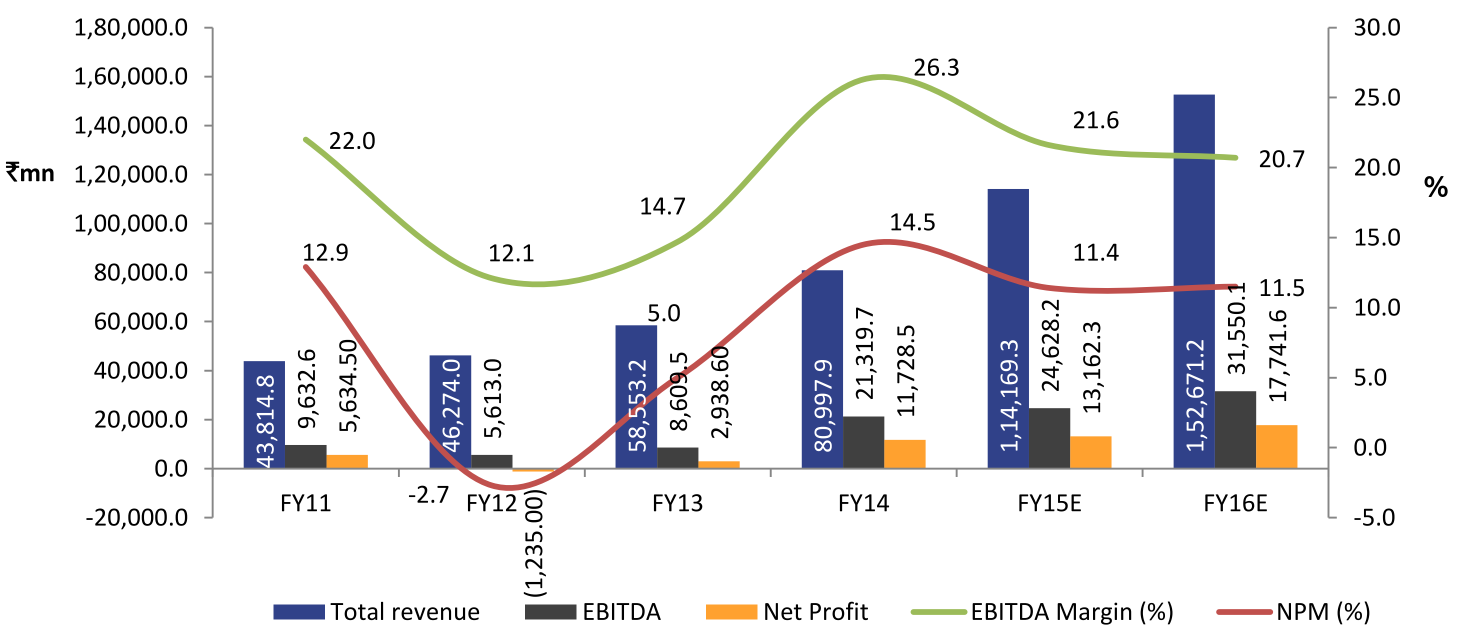
Auro Pharma, founded in 1986, is a global pharmaceutical company. Headquartered in Hyderabad (India), the company is engaged in developing, manufacturing and marketing active pharmaceutical ingredients (APIs), intermediates and generic formulations. The company's product portfolio is spread across six major product areas, namely, antibiotics, anti-retrovirals, cardiovascular (CVS) products, central nervous system (CNS) products, gastroenterologicals, and anti-allergics, with around 65 APIs in the non-antibiotics and over 55 APIs in the antibiotic segment. Auro Pharma features among the top 10 companies in India (in terms of consolidated revenues) and among the world's top 5 manufacturers of Semi-Synthetic Penicillins.

The company exports to over 125 countries across the globe with more than 70% of its revenues derived out of international operations, its key customers being premium multi-national companies.

The company runs its operations through 14 manufacturing plants across the world conforming to GMP/ISO regulations and has an extremely well equipped R&D facility. Internationally, the company's operations span across key geographies including the US, Canada, Mexico, Europe, Africa, Asia, Australia, CIS and GCC. The company has strategic alliances with global pharmaceutical majors to cater to their formulation manufacturing needs. Auro Pharma is one of the well-known global suppliers of generic Antiretroviral (ARV) drugs. The company exports to over 125 countries across the globe with more than 70% of its revenues derived out of international operations, its key customers being 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, Auro Pharma 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. Auro Pharma is among the largest filers of DMFs and ANDAs from India. 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 a revenue of USD 2 bn by FY16.

Consistent growth in revenue and profitability over years reflects promising outlook for Auro Pharma



Strong show in Q2FY15 led by traction in US formulation business

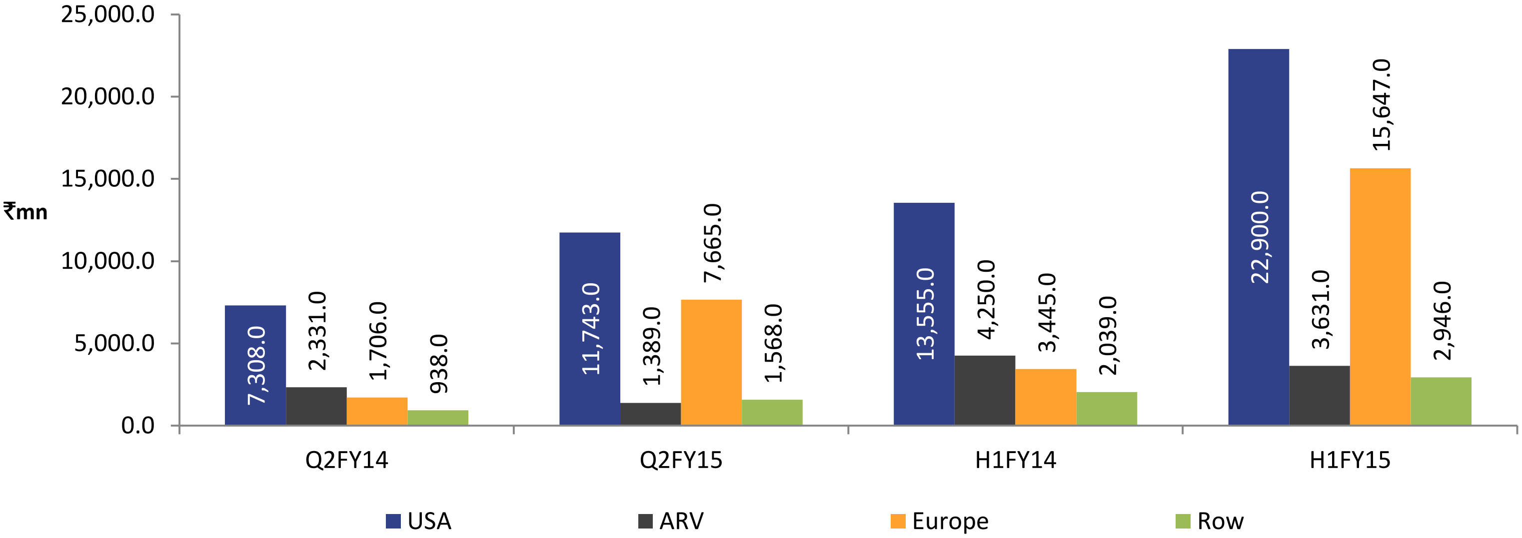
The company's revenues from operations grew by 50.8% YoY to ₹28,621.9 mn in Q2FY15 as against ₹18,974.8 mn in the corresponding period a year earlier, led by strong growth in revenue from the US formulations.

The US business remained key driver for growth in net sales: Auro Pharma showcased a robust performance in the second quarter of the current fiscal, with total revenues (post acquisition of the Irish drug maker Actavis' loss-making generics operations in seven western European countries) soaring by 50.5% YoY to ₹28,812.2 mn as against ₹19,138.6 mn in the corresponding period a year earlier, led by strong growth in revenue from the US formulations. Revenue from the US (contributed ~ 52.5% to the total revenue in Q2FY15) grew by 60.7% YoY in Q2FY15 to ₹11,743.0 mn as against ₹7,308.0 mn in Q2FY14. A triple digit growth in revenue from the European formulation, which contributed ~34.3% to the total revenue in Q2FY15, up by 349.3% YoY to ₹7,665.0 mn compared to ₹1,706.0 mn in Q2FY14, further supported the top-line.

The increased proportion of higher margin US formulation business compared to relatively lower margin ARV formulation and API led to better product mix for the quarter.

The increased proportion of higher margin US formulation business compared to relatively lower margin ARV formulation and API led to better product mix for the quarter. Revenue from ARV formulations declined by 40.4% YoY to ₹1,389.0 mn in Q2FY15 from ₹2,331.0 mn in Q2FY14. While the overall formulation sales grew by 82.1% YoY to ₹12,283 mn in Q2FY15 as against ₹22,365 mn in Q2FY14, revenue from the API segment declined by 4.6% YoY to ₹6,850 mn during the quarter as against ₹7,179 mn in the same period last year. The company witnessed a strong growth in its consolidated net profit at ₹3,721.8 mn in Q2FY15 as against ₹2,349.5 mn in Q2FY14, marking an uptick by 58.4% YoY.

Higher revenue from the US and European formulations supported the top-line growth

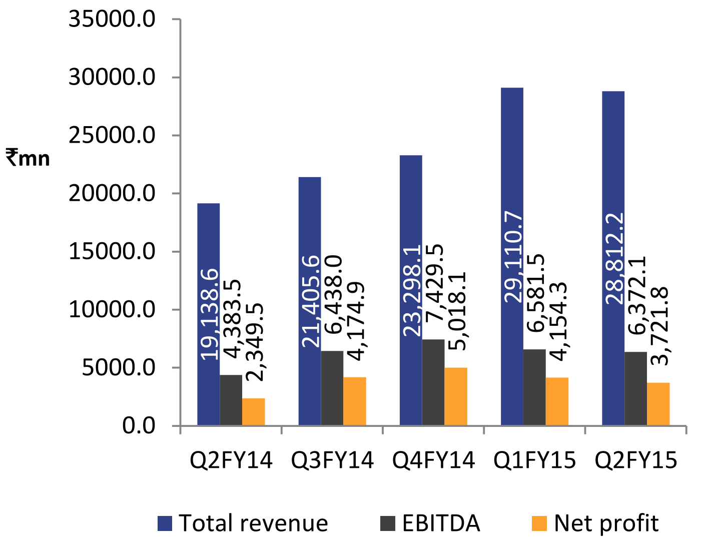


The decline in EBITDA margin was mainly on account of increase in staff cost and other expenses partly due to the integration of the recently acquired Actavis operations.

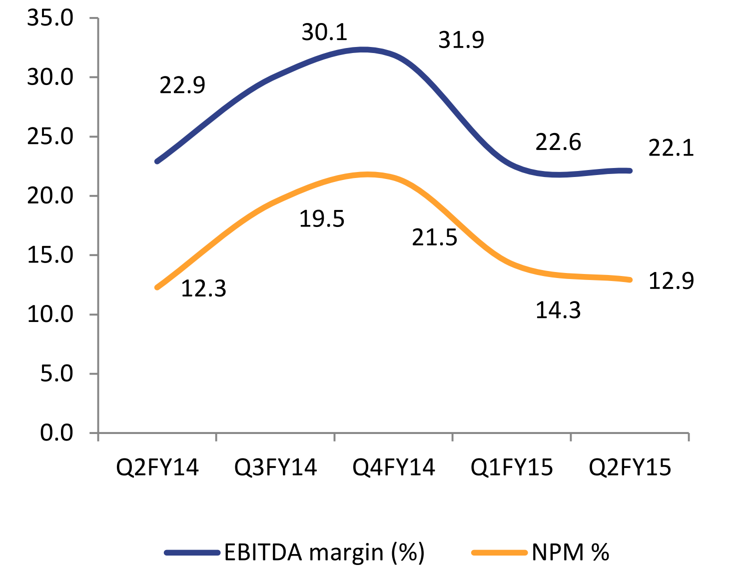
EBITDA margin contracted by 80bps YoY on higher staff cost and other expenses: EBITDA, during the quarter, grew by 45.4% YoY to ₹6,372.1 mn in Q2FY15 as against ₹4,383.5 mn in Q2FY14, however, EBITDA margin contracted by 80bps YoY to 22.1% as against 22.9% in Q2FY14. The decline in EBITDA margin was mainly on account of increase in staff cost and other expenses (as a percentage of net sales) by 1.5% and 3.4% respectively, which counterbalanced the positive impact of a decrease in raw material cost (as a percentage of net sales) by 4.1%. Higher employee cost and other expenditure is partly due to the integration of recently acquired Actavis operations.

Witnessed healthy numbers in H1FY15: For the first half ended September 2014, the company has reported a whopping 60.0% YoY increase in net sales to ₹57,568.0 mn as against ₹35,970.8 mn in H1FY14 and its net profit went up sharply by 210.6% to ₹7,876.1 mn in H1FY15 compared to ₹2,535.5 mn in H1FY14 despite higher employees cost of ₹6,453.4 mn in H1FY15 as against ₹3,848.7 mn in H1FY14. Foreign exchange loss declined to ₹406 mn from ₹2,407 mn. However, its taxation provision moved up to ₹2,868.6 mn in H1FY15 as against ₹645.6 mn in the corresponding period a year ago.

Quarterly performance trend



Impact on margins due to Actavis acquisition (in April 2014) was neutralised by US business led growth



On the back of a satisfactory performance in Q2FY15 and H1FY15 led by US business along with healthy performance in Europe and other markets, the management believes that the company will continue to show the strong performance with its continuous focus on complex molecules and differentiated technology platforms for advanced markets.

Strong product pipeline to aid US business

The US formulations contributed ~52.5% to the total revenue in Q2FY15.

Auro Pharma's US formulations business remained the show-stopper in Q2FY15 with its quarterly sales figures registering a growth of 60.7% YoY at ₹11,743.0 mn (USD 196 mn) led by a slew of new product launches in the controlled substances in the preceding quarters and increased traction in existing products. The US formulations contributed ~52.5% to the total revenue in Q2FY15.

Revenue from the sale of cephalosporin which stood at USD 12 mn in Q2FY15, also boosted the overall revenue from the US. The US Food and Drug Administartion (USFDA) has put an import alert on products from the company's Hyderabad-based cephalosporin facility in 2011, as a result of which its exports to the US market were affected. However, the USFDA lifted the import alert in Q4FY14, thereby allowing the company to export 9 products from this plant to the US market, which also resulted in higher revenue from the region. Further, the US based wholly owned subsidiary, Aurolife also showed better traction with sales in the range of USD 25-30 mn for the quarter, up by 25-30% on a QoQ basis. Auromedics maintained the sales momentum with sales of USD 17 mn for the quarter, up by 119% YoY and 15% QoQ.

After filing its first ANDA in the US in 2003, the company has come a long way with ANDA filings standing at 378 in Q2FY15.

After filing its first ANDA in the US in 2003, the company has come a long way with ANDA filings standing at 378 in Q2FY15. During Q2FY15, the company's US business has filed two ANDAs. During the quarter, the company received final approvals for Amoxicillin for Oral Suspension (USP 125mg/5mL and 250mg/5mL) and Phentermine Hydrochloride Tablets, (USP 37.5mg), and a tentative approval for Fexofenadine HCl Tablets (USP 30mg, 60mg, 180mg) taking the cumulative approvals to 197. **With robust pipeline of 181 ANDAs pending for approval, we believe that the company would be able to maintain sales momentum, if approvals are received at regular pace.**

Global regulatory filings

Filings	Q1FY15	Q2FY15	Cumulative Filings as on 30th Sep 2014
ANDAs (USA)	40	2	378
DMFs (USA)	-	2	183
Formulations Dossiers in other key advanced markets (incl. Multiple registrations into Europe. South Africa, Australia and Canada)	23	94	2,214
API DMF/COS filings in other key regulated markets	45	34	2,316
Patents	9	6	576

Replacing Actavis products with low cost-high margin Auro Pharma's products - a move that will bring a noteworthy improvement in profitability and margins

Auro Pharma entered into a long-term commercial and supply arrangement with Actavis to support the growth plans of its loss-making operations.

With the completion of the consolidation process, we believe the company will see an improvement in profitability and margins which accelerates its chances of becoming a significant player in Europe.

In a move to become one of the leading Indian pharmaceutical companies in Europe, Auro Pharma acquired the loss-making generics operations of the Irish drug-maker, Actavis, in seven western European countries, in April 2014. Aurobindo has acquired the personnel, commercial infrastructure, products, marketing authorisations and dossier licence rights in France, Italy, Spain, Portugal, Belgium, Germany and the Netherlands. The company entered into a long-term commercial and supply arrangement with Actavis to support the growth plans of these operations. After funding the acquisition through its internal accruals, Auro Pharma has full confidence of turning these loss-making operations into the profitable ones with the help of its vertically integrated platform. Since 2006, Aurobindo has been expanding its reach in Europe, with operations in the UK, Spain and Germany. The Actavis deal will ideally accelerate the company's strategy of pursuing growth in European operations, providing critical scale and elevating it to one of the leading companies in the generic markets in the region.

During Q2FY15, the company's management has indicated that it will consolidate Actavis' operations in three stages. The first stage involves the front end integration of operations (that is being achieved in H1FY15). In second stage, the company plans to replace half of Actavis products (~200 out of 450) with Auro Pharma's own low-cost high-margin products, which the company plans to complete over the next 24 months; in a move to bring down its overall costs. In the third and the final stage (which will take another 12-15 months more), Auro Pharma plans to move some of the acquired entity's products to its own site in India, thereby reducing the costs and enhancing the margins.

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Plans to buy US-based Natrol Inc. in order to expand OTC products business in the US

The company's management believes that Natrol is an excellent strategic fit and provides the company a right platform for creating a fully-integrated OTC platform in the US and in other international markets.

The company is planning to buy the US-based nutritional supplements maker, Natrol Inc. for a consideration of USD 133 mn (~₹8,180 mn). The company's management believes that Natrol is an excellent strategic fit and provides the company a right platform for creating a fully-integrated OTC platform in the US and in other international markets. Natrol, which manufactures and sells nutritional supplements in US and other international market, provides Aurobindo with – 1) Strong brand reputation and presence in a variety of attractive supplement markets, 2) Proven performance in the mass market, health food and speciality channels and 3) Existing long term relationship with key distribution and retail partners addressing a broad range of consumers and an effective growth strategy to expand market penetration. With the abovesaid acquisition, Auro Pharma will be able to expand its over-the-counter (OTC) products business in the US, which will result in better profitability in the coming time.

Key Risks and Concerns

Competitiveness and challenges from Indian and foreign peers; price controls and dependence on one market are some of the key challenges that Auro Pharma faces, however, the company is well equipped to cope up with the aforementioned challenges.

- The pharmaceutical industry is highly competitive and the challenges are from the Indian manufacturers who have similar production facilities as well as those from abroad. However, Aurobindo has unique capabilities to face competition from its peers. This risk would not significantly impact the company owing to its integrated manufacturing process and demonstrated operational efficiencies all of which are designed to offer products at competitive prices.
- Some of Aurobindo's products are subject to price controls. The price controls limit the financial benefits of growth in the life sciences market and the introduction of new products. But, the company is able to cope with pricing pressures and the focus on quality assurance has minimized the possibilities of commoditization. The in-house R&D is striving to develop cost effective products by redefining the production process/facility.
- Aurobindo is significantly dependent on the US market for its business. Failure to continue the profitable operations in that market could have adverse impact on the company's business, operations and financial condition. This scenario poses the risk of concentration and dependence on one market. However, in order to reduce the concentration risks, the company has been spreading its business into European, Australian and Japanese markets, which will help the company to minimise this risk to an extent.

Balance Sheet (Consolidated)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Share Capital	291.2	291.5	291.5	291.5
Reserve and surplus	25,766.4	37,210.0	49,019.4	65,408.1
Net Worth	**26,057.6**	**37,501.5**	**49,310.9**	**65,699.6**
Minority Interest	110.0	256.7	320.9	401.1
Total debt	33,843.8	36,339.2	48,173.0	60,640.7
Provisions	890.9	1,357.8	1,889.0	2,486.5
Deferred tax liability (net)	680.0	2,054.2	2,875.9	3,738.6
Other Liabilities	11,146.2	17,388.8	24,344.3	32,432.2
Total equity & liabilities	**72,728.5**	**94,898.2**	**126,913.9**	**165,398.7**
Fixed assets	28,573.8	30,313.9	40,919.2	53,195.0
Investments	222.8	197.9	197.9	197.9
Loans & advances	5,699.0	11,662.3	15,455.8	17,330.4
Deferred tax assets	0.0	0.5	0.5	0.5
Cash	2,084.5	1,785.8	2,853.3	3,582.0
Other Assets	36,148.4	50,937.8	67,487.2	91,092.8
Total assets	**72,728.5**	**94,898.2**	**126,913.9**	**165,398.7**

Key Ratios (Consolidated)

Y/E	FY13A	FY14A	FY15E	FY16E
EBITDA Margin (%)	14.7	26.3	21.6	20.7
EBIT Margin (%)	10.9	22.7	18.8	18.3
NPM (%)	5.0	14.5	11.5	11.6
ROCE (%)	16.7	35.0	31.8	32.4
ROE (%)	11.3	31.3	26.7	27.0
Adj. EPS (₹)	10.1	40.2	45.1	60.8
P/E (x)	111.1	27.9	24.8	18.4
BVPS (₹)	89.4	128.6	169.1	225.3
P/BVPS (x)	12.5	8.7	6.6	5.0
EV/Net sales (x)	6.1	4.5	3.3	2.5
EV/EBITDA (x)	41.7	17.0	15.1	12.2

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Total revenue	**58,553.2**	**80,997.9**	**114,169.3**	**152,671.2**
Expenses	49,943.7	59,678.2	89,541.1	121,121.2
EBITDA	**8,609.5**	**21,319.7**	**24,628.2**	**31,550.1**
Other Income	285.4	232.4	232.4	232.4
Depreciation	2,487.4	3,125.3	3,437.8	3,781.6
EBIT	**6,407.5**	**18,426.8**	**21,422.8**	**28,000.8**
Interest	2,666.4	3,101.6	3,473.8	3,890.6
Profit Before Tax	**3,741.1**	**15,325.2**	**17,949.0**	**24,110.2**
Tax	827.1	3,634.5	4,833.9	6,429.1
PAT before Minority interest	**2,914.0**	**11,690.7**	**13,115.1**	**17,681.1**
Minority interest	24.6	37.8	47.25	60.48
Net profit	**2,938.6**	**11,728.5**	**13,162.3**	**17,741.6**

Valuation and view

The company presented strong numbers in Q2FY15, with consolidated revenue as well as net profit soaring above 50%. Revenue from the US and Europe as well as from other geographies remained in line with expectations in Q2FY15. We expect the revenue contributed from Europe to grow from the current ~34.3%, on the back of ongoing consolidation process of the recently acquired Actavis (in April 2014). Further, Auro Pharma acquired the US-based nutritional supplements maker, Natrol Inc (in November 2014), which will provide the company a right platform for creating a fully-integrated OTC platform in the US and in other international markets. On the back of sustained growth in the US business, expectations for a growing business in Europe, healthy regulatory filings and the recent acquisitions, we believe the company will see further improvement in revenue base and profitability in the coming years.

We initiate BUY rating on Auro Pharma. At a current CMP of ₹1,120.9, Auro Pharma is currently trading at P/E of 24.8x FY15E and 18.4x FY16E. Considering the company's strong fundamentals, we recommend 'BUY' with a target price of ₹1,340, which implies potential upside of ~20% to the CMP from 1 year perspective.

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