

September 6, 2018

Event Update

■ Change in Estimates | ■ Target | ■ Reco

Change in Estimates

	Current		Previous	
	FY19E	FY20E	FY19E	FY20E
Rating	BUY		BUY	
Target Price	909		909	
Sales (Rs. m)	1,76,776	1,94,386	1,76,776	1,94,386
% Chng.	-	-	-	-
EBITDA (Rs. m)	39,421	43,348	39,421	43,348
% Chng.	-	-	-	-
EPS (Rs.)	46.1	50.5	46.1	50.5
% Chng.	-	-	-	-

Key Financials

	FY17	FY18	FY19E	FY20E
Sales (Rs. m)	1,48,448	1,62,329	1,76,776	1,94,386
EBITDA (Rs. m)	31,892	35,216	39,421	43,348
Margin (%)	21.5	21.7	22.3	22.3
PAT (Rs. m)	23,017	23,952	27,016	29,593
EPS (Rs.)	39.3	40.9	46.1	50.5
Gr. (%)	13.5	4.1	12.8	9.5
DPS (Rs.)	1.9	-	4.5	4.5
Yield (%)	0.3	-	0.6	0.6
RoE (%)	27.6	22.8	20.8	19.0
RoCE (%)	22.0	20.5	19.2	18.7
EV/Sales (x)	3.2	2.9	2.7	2.5
EV/EBITDA (x)	14.8	13.5	12.2	11.0
PE (x)	19.3	18.6	16.5	15.0
P/BV (x)	4.7	3.8	3.1	2.6

Key Data

ARBN.BO | ARBP IN

52-W High / Low	Rs.809 / Rs.527
Sensex / Nifty	38,243 / 11,537
Market Cap	Rs.445bn/ \$ 6,190m
Shares Outstanding	586m
3M Avg. Daily Value	Rs.3489.27m

Shareholding Pattern (%)

Promoter's	51.87
Foreign	17.99
Domestic Institution	15.64
Public & Others	14.50
Promoter Pledge (Rs bn)	-

Stock Performance (%)

	1M	6M	12M
Absolute	21.6	25.3	1.6
Relative	19.8	9.1	(15.9)

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Sandoz portfolio acquisition positive, EPS accretion likely from FY20

ARBP has acquired a selected group of products of Sandoz in derma, CNS, women healthcare and hormonal drugs in US. The net addition of sales and EBITDA post acquisition is likely to be US\$900m and US\$180m, respectively. With all-cash deal of US\$900m, the acquisition is valued at 1x P/Sales and 5x EV/EBITDA, which is cheapest generic acquisition in US in recent times. With linkage to captive API, diversification of US portfolio and de-risking of manufacturing activities, we expect the acquisition to be EPS accretive from the first year of integration which is likely to be in FY20E. We maintain 'Buy' and retain TP at Rs909 (18x FY20 EPS).

- ARBP acquires a portfolio of products from Sandoz in US:** ARBP has agreed to acquire select portfolio of dermatology and oral solid (OSD) products from Sandoz in US for a consideration of US\$900m in an all-cash deal plus US\$100m of potential earn-outs. The transaction is a win-win situation for both the companies as ARBP wants to focus/lead in lesser competitive generics (i.e. Derma and controlled substance) in US while Sandoz rationalized its assets to launch more complex generics (Injectable, respiratory, ophthalmic), value added medicines (Specialty products) and biosimilars. The transaction value is inclusive of working capital, near term opportunities and potential upside from pipeline products. ARBP will receive three plants along with the host of portfolio as the transaction is on a cash-free and debt free basis and the deal is expected to be closed in CY19.
- Acquired plants to de-risk high dependence on productions in India:** As a part of the transaction, ARBP to receive two dermatology plants in New York (Melville and Hicksville), one OSD plant in Wilson, New Carolina and one R&D center for derma products. This will serve ARBP's initiative to de-risk its high dependence on formulation plant in India. ARBP has set up two plants and one large R&D center in recent past in US.
- Additions of employees, products/brands commensurate each other:** With addition of 300 products as well as additional development projects, there will be addition of 750 employees as a part of the agreement. The additional headcount includes employees from three plants, scientists in Eon Labs (R&D center for Derma products) as well as field representatives of branded (PharmaDerm) dermatology business.
- Acquisition to increase net sales by ~US\$900m:** With rationalization of portfolio in generics, the net sales addition for ARBP from acquisition will be US\$900m with EBITDA margin of ~20% (US\$180m). Pre rationalization, the current portfolio's sales and EBITDA margin was US\$1,200m and 18.8% (US\$225m) in CY17. The contribution of OSD and Derma products are 70% and 30% respectively. The key products are Levothyroxin and Budesonide. Branded generics contributed US\$50m revenues in CY17 while Sandoz has sizeable revenues from authorised generics (AG) and in-licensed products though contributions in EBITDA were minimal.

Evaluation of the acquisition

- **Synergies to be accrued from foray in new therapies, captive APIs:** With ARBP's track record of high linkage (85%) of US portfolio with captive APIs, we expect there will be sourcing of APIs from Indian plants for the major part of portfolio in 2-3 years post completion of the deal. This will compensate the erosion of value and margin in its key products in US.
- **Existing network to benefit in launching new brands, OTC products:** ARBP's medium to long term plan to foray in branded and OTC space will receive boost. With current network of its branded business and OTC drugs, ARBP expects OTC business in US to achieve US\$60m revenues in FY19E, up from US\$16m in FY18.
- **Acquisition at 1xPrice/sales, a new low in recent times:** With effective sales of US\$900m and EBITDA of US\$180m, the proposed deal is valued at 1x Price/Sales and 5x EV/EBITDA. Considering further benefits of net working capital of US\$225m (including approximate inventory of US\$100m at cost of production), the effective payout will be further lower. However, the clarity over net payout will emerge once USFTC approval is received along with forced dilution of some of the assets, if any.
- **Approval from USFTC, market conditions key monitorable:** The opportunity of increase in sales and margins on the back of approval of pipeline products and linkage with captive APIs will be contingent on multiple factors including time of approval, competitive intensity and erosion in existing portfolio. We expect ARBP's to maintain track record of net growth of ~8-10% in US portfolio despite headwinds of price erosion in FY19E-20E. The acquisition of Sandoz portfolio has the potential to increase FY20 EPS by Rs11.3 (23%) in FY20E. Maintain 'Buy' with TP at Rs909 (18XFY20 EPS) without assuming acquisition benefits.



Financials

Income Statement (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
Net Revenues	1,48,448	1,62,329	1,76,776	1,94,386
YoY gr. (%)	8.3	9.4	8.9	10.0
Cost of Goods Sold	64,343	67,527	75,925	83,489
Gross Profit	84,105	94,801	1,00,851	1,10,897
Margin (%)	56.7	58.4	57.1	57.1
Employee Cost	17,678	21,308	19,887	21,868
Other Expenses	5,430	6,669	10,607	11,663
EBITDA	31,892	35,216	39,421	43,348
YoY gr. (%)	8.4	10.4	11.9	10.0
Margin (%)	21.5	21.7	22.3	22.3
Depreciation and Amortization	4,276	5,580	6,568	7,397
EBIT	27,616	29,636	32,853	35,951
Margin (%)	18.6	18.3	18.6	18.5
Net Interest	667	777	1,021	941
Other Income	3,610	3,690	3,911	4,146
Profit Before Tax	30,558	32,548	35,743	39,156
Margin (%)	20.6	20.1	20.2	20.1
Total Tax	7,596	8,463	8,757	9,593
Effective tax rate (%)	24.9	26.0	24.5	24.5
Profit after tax	22,962	24,086	26,986	29,563
Minority interest	(55)	(34)	(30)	(30)
Share Profit from Associate	-	-	-	-
Adjusted PAT	23,017	23,952	27,016	29,593
YoY gr. (%)	13.7	4.1	12.8	9.5
Margin (%)	15.5	14.8	15.3	15.2
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	23,017	23,952	27,016	29,593
YoY gr. (%)	13.7	4.1	12.8	9.5
Margin (%)	15.5	14.8	15.3	15.2
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	23,017	23,952	27,016	29,593
Equity Shares O/s (m)	586	586	586	586
EPS (Rs)	39.3	40.9	46.1	50.5

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
Non-Current Assets				
Gross Block	52,292	70,638	95,469	1,16,341
Tangibles	47,998	59,555	81,550	1,00,047
Intangibles	4,294	11,083	13,918	16,294
Acc: Dep / Amortization	8,017	13,597	20,165	27,562
Tangibles	7,168	12,189	17,722	23,969
Intangibles	850	1,407	2,443	3,593
Net fixed assets	44,275	57,041	75,303	88,779
Tangibles	40,831	47,366	63,829	76,078
Intangibles	3,444	9,676	11,475	12,701
Capital Work In Progress	14,581	15,830	11,873	6,500
Goodwill	4,063	8,165	8,165	8,165
Non-Current Investments	3,267	4,044	4,276	4,567
Net Deferred tax assets	1,185	(765)	1,483	2,658
Other Non-Current Assets	2,569	2,504	3,130	3,913
Current Assets				
Investments	0	0	0	0
Inventories	43,305	58,584	61,766	65,265
Trade receivables	27,653	30,844	30,512	33,551
Cash & Bank Balance	5,135	12,616	4,215	2,619
Other Current Assets	8,283	11,790	12,969	14,266
Total Assets	1,62,494	2,11,052	2,23,332	2,40,364
Equity				
Equity Share Capital	586	586	586	586
Other Equity	93,133	1,16,218	1,41,908	1,68,416
Total Network	93,719	1,16,804	1,42,494	1,69,001
Non-Current Liabilities				
Long Term borrowings	1,814	4,512	2,256	1,128
Provisions	224	559	698	873
Other non current liabilities	-	-	-	-
Current Liabilities				
ST Debt / Current of LT Debt	31,827	40,313	36,413	33,113
Trade payables	24,883	26,274	26,153	25,563
Other current liabilities	9,513	20,218	14,153	9,550
Total Equity & Liabilities	1,62,494	2,11,052	2,23,332	2,40,364

Source: Company Data, PL Research



Cash Flow (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
PBT	30,558	32,548	35,743	39,156
Add. Depreciation	4,276	5,580	6,568	7,397
Add. Interest	667	777	1,021	941
Less Financial Other Income	3,610	3,690	3,911	4,146
Add. Other	(1,089)	(1,582)	(472)	(1,254)
Op. profit before WC changes	34,413	37,323	42,860	46,240
Net Changes-WC	6,110	(10,405)	(10,504)	(13,379)
Direct tax	(7,737)	(8,267)	(9,829)	(10,768)
Net cash from Op. activities	32,786	18,650	22,526	22,093
Capital expenditures	(16,846)	(19,596)	(20,873)	(15,500)
Interest / Dividend Income	155	158	161	164
Others	(1,179)	(657)	-	-
Net Cash from Inv. activities	(17,870)	(20,095)	(20,712)	(15,336)
Issue of share cap. / premium	67	-	-	-
Debt changes	(17,279)	11,184	(6,156)	(4,428)
Dividend paid	(1,372)	-	(3,085)	(3,085)
Interest paid	(568)	(777)	(1,021)	(941)
Others	(2)	-	-	-
Net cash from Fin. activities	(19,154)	10,407	(10,262)	(8,453)
Net change in cash	(4,239)	8,963	(8,447)	(1,696)
Free Cash Flow	15,940	(945)	1,654	6,593

Source: Company Data, PL Research

Quarterly Financials (Rs m)

Y/e Mar	Q2FY18	Q3FY18	Q4FY18	Q1FY19
Net Revenue	43,542	42,690	39,886	41,816
YoY gr. (%)	17.3	11.0	11.3	15.5
Raw Material Expenses	17,679	18,175	16,695	19,073
Gross Profit	25,863	24,515	23,192	22,743
Margin (%)	59.4	57.4	58.1	54.4
EBITDA	10,356	9,585	7,436	7,105
YoY gr. (%)	32.1	(7.4)	(22.4)	(4.4)
Margin (%)	23.8	22.5	18.6	17.0
Depreciation / Depletion	1,321	1,381	1,566	1,545
EBIT	9,035	8,204	5,869	5,560
Margin (%)	20.8	19.2	14.7	13.3
Net Interest	173	189	247	295
Other Income	915	1,002	884	443
Profit before Tax	9,778	9,017	6,506	5,707
Margin (%)	22.5	21.1	16.3	13.6
Total Tax	1,980	3,069	1,224	1,155
Effective tax rate (%)	20.2	34.0	18.8	20.2
Profit after Tax	7,798	5,948	5,282	4,552
Minority interest	(13)	(3)	(3)	(5)
Share Profit from Associates	-	-	-	-
Adjusted PAT	7,812	5,950	5,285	4,557
YoY gr. (%)	29.0	2.8	(0.7)	(12.1)
Margin (%)	17.9	13.9	13.3	10.9
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	7,812	5,950	5,285	4,557
YoY gr. (%)	29.0	2.8	(0.7)	(12.1)
Margin (%)	17.9	13.9	13.3	10.9
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	7,812	5,950	5,285	4,557
Avg. Shares O/s (m)	586	586	586	586
EPS (Rs)	13.3	10.2	9.0	7.8

Source: Company Data, PL Research

Key Financial Metrics

Y/e Mar	FY17	FY18	FY19E	FY20E
Per Share(Rs)				
EPS	39.3	40.9	46.1	50.5
CEPS	46.6	50.4	57.3	63.1
BVPS	160.0	199.4	243.2	288.4
FCF	27.2	(1.6)	2.8	11.3
DPS	1.9	-	4.5	4.5
Return Ratio(%)				
RoCE	22.0	20.5	19.2	18.7
ROIC	17.5	14.9	15.0	15.1
RoE	27.6	22.8	20.8	19.0
Balance Sheet				
Net Debt : Equity (x)	0.3	0.3	0.2	0.2
Net Working Capital (Days)	113	142	137	138
Valuation(x)				
PER	19.3	18.6	16.5	15.0
P/B	4.7	3.8	3.1	2.6
P/CEPS	59.8	64.7	73.6	81.0
EV/EBITDA	14.8	13.5	12.2	11.0
EV/Sales	3.2	2.9	2.7	2.5
Dividend Yield (%)	0.3	-	0.6	0.6

Source: Company Data, PL Research

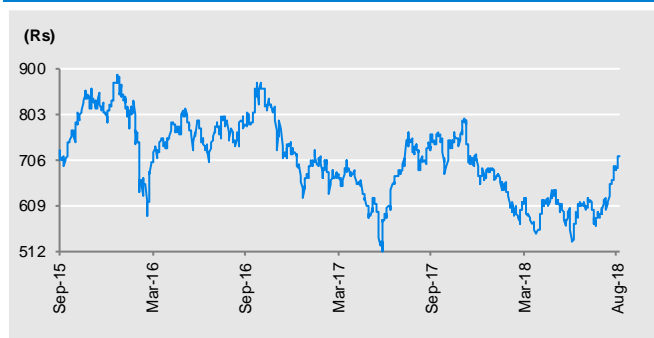
Key Operating Metrics (Rs m)

Y/e Mar	FY17	FY18	FY19E	FY20E
US Formulations	68,272	76,921	84,614	94,507
EU & ROW	40,327	43,536	47,562	52,765
ARV formulations	11,854	13,276	14,604	16,312
APIs	30,420	29,151	29,971	30,776

Source: Company Data, PL Research



Price Chart



Recommendation History

No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	14-Sep-17	BUY	877	759
2	09-Oct-17	BUY	877	744
3	10-Nov-17	BUY	877	740
4	17-Nov-17	BUY	877	713
5	13-Dec-17	BUY	877	669
6	10-Jan-18	BUY	877	673
7	09-Feb-18	BUY	909	602
8	12-Feb-18	BUY	909	590
9	05-Mar-18	BUY	909	601
10	15-Mar-18	BUY	909	573

Analyst Coverage Universe

Sr. No.	CompanyName	Rating	TP (Rs)	Share Price (Rs)
1	Aurobindo Pharma	BUY	909	611
2	Cadila Healthcare	Accumulate	437	354
3	Cipla	Reduce	525	633
4	Dr. Lal PathLabs	Accumulate	1,009	941
5	Dr. Reddy's Laboratories	Reduce	1,766	2,133
6	Eris Lifesciences	Accumulate	885	703
7	Glenmark Pharmaceuticals	Reduce	472	589
8	Indoco Remedies	Reduce	184	180
9	Ipca Laboratories	BUY	829	679
10	Jubilant Life Sciences	Accumulate	880	795
11	Lupin	Reduce	727	823
12	Sun Pharmaceutical Industries	Reduce	447	602
13	Thyrocare Technologies	BUY	795	611

PL's Recommendation Nomenclature (Absolute Performance)

Buy	: > 15%
Accumulate	: 5% to 15%
Hold	: +5% to -5%
Reduce	: -5% to -15%
Sell	: < -15%
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly



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