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Aurobindo: European prospects brighten

Long-term gains from the European acquisition outweigh likely near-term stress on margins; this, along with a strong US pipeline, points to good prospects

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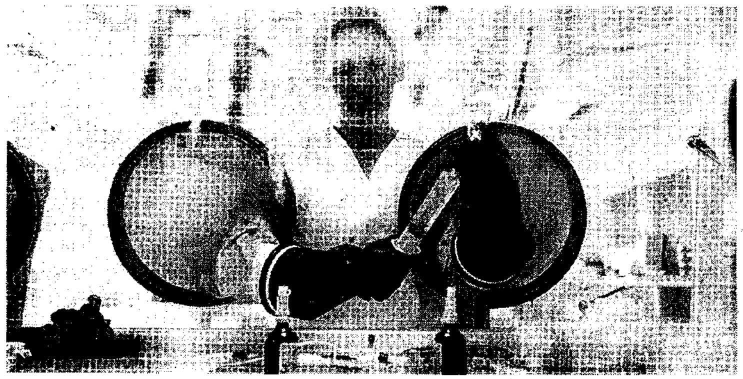
After expanding its exports basket and ramping up facilities, Aurobindo Pharma has gone a step forward by strengthening its front-end in Europe. It signed a 'binding offer' to acquire commercial operations in seven western European countries from global pharma major Actavis. The markets have given a thumbs up to the acquisition, with the stock gaining 13 per cent in last two days, closing at ₹435.15 on the BSE on Tuesday, up 6.33 per cent.

While some analysts say they will revisit their target prices after the results, adding the Aurobindo-Actavis deal will take some time to close, among the few recommendations in past one-two days, analysts at Prabhudas Lilladher have a target price of ₹482, CIMB ₹500, Sharekhan ₹470 and Emkay Global ₹406, which largely indicates there is room for further upside.



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Acquisition to impact near-term margins

Aurobindo is spending €30 million (about ₹250 crore) on the acquisition, which will enable it to strengthen its operations in countries such as France, Italy, Spain, Portugal, Germany, the Netherlands and Belgium. It will get access to Actavis's personnel, commercial infrastructure, products (about 1,200), marketing authorisations and dossier licences. Further, Aurobindo will also get readymade hospital-sales infrastructure to launch its own injectable and specialty portfolio across western Europe. The entity being acquired is estimated to have clocked sales of €320 million (₹2,670 crore) in 2013 and is growing at 10 per cent, according to a company release.

While all these bode well, the key concern in the near term is the operations being acquired are loss-making. It is estimated to have recorded earnings before interest, tax, depreciation and amortisation loss of €20 million in FY13, say analysts at Emkay Global. The consolidated margins of Aurobindo could be impacted by 150-200 points on the first day after the acquisition, believe analysts at Sharekhan.

Positive in the long term

While the concern may be valid, valuations of the deal are very attractive. Aurobindo is getting the front-end operations and products at a tenth of the sales value. Also, it is not taking any manufacturing facility or debt of Actavis and, therefore, there will be no stress on Aurobindo's balance sheet.

Analysts believe Aurobindo can turn around the business fast. While it was already a supplier of active pharmaceutical ingredients for some products to Actavis, its backward integrated operations should help improve the profitability of the latter. Besides Actavis products, Aurobindo will launch its own product range in the injectibles and generics segments, among others. To sell its generics, Aurobindo will get access to brand 'Arrow Generiques', which has high acceptance in European countries.

Ranjit Kapadia at Centrum Broking believes Aurobindo will be able to turn around the Actavis business in a year and the business will be operationally profitable in FY16. He has a target price of ₹450 on Aurobindo and says he will revisit it this after the results. Analysts at Emkay say scaling up growth through new product launches from its own dossier filings and injectable sales to the hospital network is also a possibility.

Analysts at Sharekhan, too, foresee a fast recovery in the margin profile (of the acquired entity) through cost rationalisation, site transfer of key products and an improving margin on other products. As the acquisition will not disturb existing debt repayments and capital expenditure plans, they expect a favourable risk-reward ratio in two-three years.

Good prospects

Aurobindo's existing operations are faring well. The company has a strong product pipeline for the US and Europe. Its injectibles range is ramping up fast; so is the cephalosporin range. The company, in last month, has launched generics of Cymbalta (a neurological disorder drug).

Analysts at Bank of America-Merrill Lynch expect sales of $40 million and a profit of $25 million from the generic launch during first six months. They raised their earnings estimate for Aurobindo five per cent each for FY14/15, factoring in new launches and market-share ramp-up in existing products. They expect a stronger performance for Aurobindo in the second half of FY14, against the first half and expect the momentum to continue in FY15/16, driven by new launches in injectibles and limited competition in products. Prabhudas Lilladher analyst Pal expects Aurobindo's earnings-per-share to rise 22 per cent in FY15 to ₹36, a price/earnings ratio of 12.

STRONG PROFITABILITY GROWTH

In ₹ crore	FY13	FY14E	FY15E
Revenues	**5,855**	**7,477**	**8,898**
% change y-o-y	26.5	27.7	19.0
Ebitda	**861**	**1,413**	**1,700**
Ebitda (%)	14.7	18.9	19.1
Net profit	**429**	**861**	**1,049**
% change y-o-y	2.0	100.6	21.9
EPS (₹)	**14.7**	**29.6**	**36.0**
PE (x)	**29.6**	**14.7**	**12.0**

E: Estimates Consolidated financials Source: Prabhudas Lilladher

Company.