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Revival of Europe business key for Aurobindo Pharma

MARK TO MARKET

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Aurobindo Pharma Ltd is on a roll. As the firm resolved the US food and drug administration (FDA) issues, stepped up filings (new drug applications) and reported strong financial performance, the stock tripled in the last year. With 120 abbreviated new drug applications (ANDAs, for generic medicines) under review for the US market, the product pipeline is strong, indicating that the company is likely to continue doing well.

Growth is expected to be driven by the injectables business. Aurobindo Pharma has several products on the US authorities' shortage list. While it has launched some, approvals for several other products are expected in the coming year. "We will see a significant jump in revenue over the next year, starting towards the end of the year. One of the products on US FDA's Shortage List that was just approved that we are about ready to launch is Acyclovir," Ronald Quadrel, president of Aurobindo Pharma's US unit, said in a conference call with analysts. "There are another 11 products currently on the Shortage List for which we have already filed ANDAs that will be approved over the next year."

According to **Citigroup Global Markets Inc.**, Aurobindo Pharma aims to become the top company in the US generics injectables market by 2020. "It clocks sales of $35 million currently, which is likely to grow to $70-80 million next year," Citi Research says.

Analysts expect the overall US business to grow at an annual average rate of 20% in the next two fiscal years. While strong business prospects have led to earnings upgrades, the Aurobindo stock has reached fair value levels calculated by some broking firms (Citi Research and **Emkay Global Financial Services Ltd**, for instance).

The next trigger for the stock may come only when the Europe business shapes up. The company has recently acquired the West European operations of **Actavis Plc**. The business is losing money and is expected to weigh down Aurobindo's margins in the coming quarters.

Aurobindo Pharma plans to reach break-even levels for the acquired firm in two years through backward integration and consolidation of resources in Europe, thereby achieving economies of scale. But the complexity of the business environment means it will be difficult for Aurobindo to implement margin accretive decisions like price hikes and change of product sourcing to cheaper locations like India immediately.

"Losses have been coming down and there is potential to improve profitability, but this would take time and could involve execution challenges/delays. For now, therefore, we assume no growth and a one-year delay in break-even vis-à-vis the management's expectations of two years," Citi Research said in a note.

Even though prospects in the US are strong, Aurobindo Pharma will also need the push from the European business to repeat the recent performance. While analysts are sounding cautious, proof that the Europe business is on track for better profitability will help the stock continue its outperformance.

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