FUNDAMENTAL PICK

LOW RISK/SUPER RETURNS

HOLDING PERIOD – ONE YEAR

DATE – 12th May 2003

AUROBINDO PHARMA
Present Price – Rs.246.50
Projected Price – Rs.500

- Aurobindo Pharma Ltd (APL) is a fast track integrated pharmaceutical company based in Hyderabad and is engaged in the manufacture of bulk drugs and bulk drugs intermediaries. APL is one of the largest manufacturers of semi-synthetic penicillin bulk drugs -- ampicillin and amoxycillin. It has integrated facilities to manufacture bulk drugs, bulk drug intermediates and formulations.
- APL ranks among the top 5 pharma companies in India by size and is a multi product, multi technology, transnational company. After creating a name for itself in producing Active Pharmaceutical Ingredients (APIs) and intermediates it is now entering the highly lucrative generics market. Today the company's products are serving consumers in over 70 countries.
- It has been consistently posting strong E.P.S. numbers and its PAT went up from Rs.12.73 cr in FY 97 to Rs.68.5 cr in FY02. It had an E.P.S. of Rs.50 plus in three consecutive years till FY2000 including on post-bonus (1:1) issue in FY99. Its equity is Rs.23.25 cr and has a strong book value of Rs.167. **Expected E.P.S for FY 03 is Rs.33.50**. Last dividend – 30%.

AUROBINDO WENT FOR A MAJOR RESTRUCTURING LAST YEAR IN ORDER TO GET READY FOR THE FUTURE. FOLLOWING ARE THE MAJOR INITIATIVES IT TOOK:

- All manufacturing facilities were upgraded and some of them have been dedicated exclusively to service the regulated markets. Inefficient plants, processes and overheads have been eliminated. Non-performing business models have been shed. Aurobindo will no longer be present in low earners or products with long gestation periods.
- The production facilities have been made cost-effective and APL rationalized its product-mix and moved into every generation of select theraeuptic segments. More number of cephalosporins and semi-synthetic pencillins have been added. At the same time unconnected products have been shed.
- APL is now increasing its presence in generics market. It is now moving up the value chain and adopting a global delivery model in order to achieve greater export penetration.

- Increased focus on R&D will drive the growth of APL in global markets. Now over 175 scientists are working in areas of process research, custom synthesis and formulations research. The company has identified 12 products in the first phase for entry into generics market.

- It has already filed for 14 process patents and two of them have been approved and the rest are under consideration.
- For gearing up to US-FDA and other regulated markets' requirements and to ensure much cheaper sources of intermediates for APIs, company has invested Rs 330 crore in a number of new initiatives. Out of this, 85-90% has been spent / committed till March 2003. Only 10-15% would spill over to FY 2004.
- Aurobindo has set us a 100% subsidiary investing US $ 30 million (Rs 150 crore) in China to make SSP and cephalosporins from the very basic stage of fermentation. Right now Penicillin G is outsourced from China and Europe to make intermediates like 6 APA, 7 ADC, 7 ACA, etc. in China, which in turn, are used to manufacture SSPs and cephalosporin APIs and finished dosage forms in India at Vizag unit.

    - The reason China was preferred as power cost there is very low (less than ½ of what it will cost in India). As power accounts for 30% of production cost of SSP from fermentation stage, cheaper source of power is essential.. Chinese government gives lot of other incentives. Climate is also ideal to develop necessary strains for developing culture to carry out fermentation process.

THIS IS THE NEW AUROBINDO

- **From a local API manufacturer it has now become a technology led player with focus on regulatory markets.**
- **From a single product, single unit producer, it has now become a multi product, multi unit within India and outside India. It is now the largest producer of semi-synthetic pencillins in India & Asia, and fourth largest in the world.**
- **From just bulk active products it has now vertically integrated products with emphasis on speciality generics.**
- **From a low value producer it has now become a high value producer with market leadership in areas of core competence.**
- **Upgraded manufacturing facilities, efficient production efficiencies, new commercially strong product lines, complete backward and forward integration.**
- **One of the strategic difference between the AUROBINDO OF THE PAST AND THE AUROBINDO OF THE FUTURE IS THE BUSINESS HAS NOW GOT DERISKED. IT WILL NO LONGER BE INVOLVED WITH THE UNCERTAININITY OF THE THE PRICE SENSITIVE COMMODITY MARKET.**

THE CHANGE IS SO ENORMOUS THAT THE AUROBINDO OF YESTERDAY CANNOT BE EXTRAPOLATED TO ASSESS THE AUROBINDO OF TOMORROW. APL OF TOMORROW WILL BE TOTALLY DIFFERENT AND WILL GROW AT A FASTER CHIP. A PARADIGM SHIFT HAS ALREADY TAKEN PLACE.

THE GROWTH DRIVERS

- Once company enters regulated markets, its sales volume, sales value and OPM% will significantly jump up. This is because regulated markets can fetch at least 7-10 times higher prices, as these are supplied from US-FDA approved facilities as per cGMP standards.
- **Backward integration will ensure assured supplies, avoid price fluctuation for Aurobindo and will increase overall efficiencies for the group as a whole. Total savings which will be mindboggling will be reflected in FY04 and FY05 results.**
- **Major growth in next two years will also come from the entry into regulated markets. It will make an aggressive entry into regulated markets. Its profits will witness an exponential growth once it enters the generics market.**
- **All the capabilities which Aurobindo has acquired/enhanced will see its turnover doubling in the next two years and the cost leadership combined with entry into genrics market will help APL report a minimum 50-75% growth in net profit in FY 04 and FY05 yoy.**
- **Improved margins on increased topline numbers will simply provide great financial strenth to the company.**

RECOMMENDATION: STRONG BUY AT CURRENT LEVELS AND AT ALL DECLINES.

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