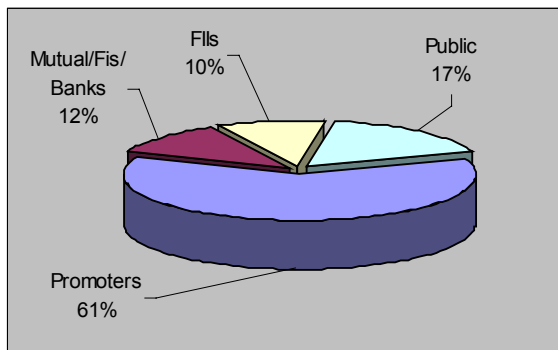


Stock Statistics	7 March 2003
Market cap (Rs Mn)	: 5,336
52-week high/low (Rs)	: 276/180
Avg. daily volume (shares)	: 8500
Face value (Rs)	: 10
BSE Sensex	: 3244.80
Nifty	: 1046.60
BSE code	: 524804
Reuters code	: ARBN.BO
Bloomberg code	: ARBP IN
Industry	: Pharmaceutical

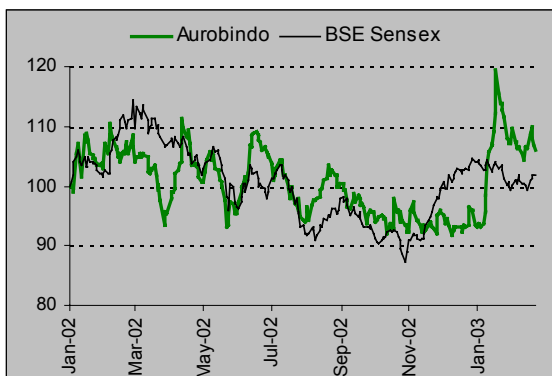
On growth path

- APL's restructuring initiative is more or less over and this will accelerate growth in the coming years. The last two years witnessed a consolidation phase. APL undertook preparatory work for future growth.
- Focusing on the generic formulations business in the regulated market, APL has upgraded its facilities to meet USFDA/UKMCA standards. The company now has two bulk and two formulation facilities that are compliant with USFDA/UKMCA standards. These facilities are expected to get regulatory approvals by FY04; sales to regulated markets are expected to grow from Q4FY04.
- Better operational efficiencies and realignment of manufacturing facilities will lead to an improvement in margins. Shift from low margin SSP products to new generation *Cephalosporin* will result in better product mix and hence better operating margins.
- During the restructuring phase, revenues were considerably affected and grew at a CAGR of 6.6% during FY01-03. We expect APL to grow FY04 onwards with revenues and PAT expected to increase by 18% and 53.4%, respectively. OPM is expected to improve from 13.6% in FY03 to 16.5% in FY04.
- The stock has been trading in a range at Rs200-250 levels in the last two years. We believe that the stock will come for a re-rating once growth begins. At current levels, the stock is trading at 4.7x FY04 earnings (average 1-year forward multiple of 6.5x). We recommend **BUY** with a 1-year target price of Rs310.

Shareholding Pattern



Aurobindo Vs Sensex: Normalised



Year to March 31	Rs Million					
	Net Sales	PAT	EPS (Rs)	PE (x)	RoCE (%)	RoNW (%)
2001	9,419	616	30.8	7.3	27.5	25.3
2002	9,737	662	32.1	7.0	21.5	20.8
2003E	10,647	749	32.2	7.0	17.5	17.6
2004E	12,563	1,148	47.4	4.7	20.1	21.2

Source: Company Reports and Karvy Estimates

Sales: Vikrant Oak
 vikrant.oak@karvy.com
 91-22-56974339

Analyst: Amit Adesara
 amit.adesara@karvy.com
 91-22-56936346/47

Investment case

Aurobindo Pharma Limited (APL), a Hyderabad-based integrated pharmaceutical company, started off with the manufacture of semi-synthetic penicillin (SSPs). APL is among the Top-5 pharma companies in India in terms of sales. APL currently manufactures more than 90 active pharma ingredients (APIs) in various therapeutic segments. APL also has a wide presence in the overseas markets and exports its products to more than 70 countries.

Two years back, APL decided to shift gears from primarily being a bulk drug manufacturer and focus on the regulated generic market. In line with this, APL embarked on a major restructuring exercise which included plant restructuring and realignments to achieve better operational efficiencies, setting up overseas subsidiaries and joint ventures and filing DMFs and ANDAs in the regulated market. We believe that with the transitory phase now over, APL is all set to grow at a faster clip FY04 onwards.

Positives

Raring to take off

Plant restructuring over

APL has a gameplan drawn out to drive its future growth. It started off restructuring and modernising its facilities. Some of the existing units were also shifted and integrated with others. For instance, APL shifted and integrated its operations at Pondicherry (discontinued), old Unit 4 (discontinued) and Unit 2 with Unit 5 and mega facility at Vizag (named as Unit 4). Post-restructuring, APL now has four facilities for API -- 2 of them USFDA/UKMCA compliant -- and two formulation facilities (both are USFDA/UKMCA compliant).

This rehaul, which entailed APL closing down/discontinuing some of its manufacturing facilities, affected its topline growth.

18% Revenue growth expected in FY04

With major capex completed, realignment of assets, upgradation to USFDA standards and disposing off inefficient plants, we believe APL will clock a growth of around 18% in revenues in FY04. Integration of some of its facilities will also achieve better operational efficiencies and economies of scale in turn improving margins.

Exhibit 1: Restructuring of manufacturing facilities

Pre-Restructuring							
Unit 1	Unit 2	Unit 3	Unit 4	Unit 5	Unit 6	Unit 6A	Unit x
Borpatla High Value Bulk Drug	Bolaram SSP*	Bachupaly Formulation	Pashmylaram Bulk drug	Pashmylaram Bulk drug	Chitkul Bulk drug	Chitkul Formulation	Pondicherry SSP*
Post-Restructuring							
Unit 1	Unit 2	Unit 3	Unit 4	Unit 5	Unit 6	Unit 6A	Unit x
Borpatla Upgraded to USFDA. Two new blocks of Cephalosporin & two new for non- Cephalosporin added	Bolaram Discontinued. Integrated with Unit five and Vizag.	Bachupaly Upgraded to USFDA and UKMCA.	Vizag Discontinued. Integrated with Unit 5 and Vizag.	Pashmylaram SSP oral. Sterile block added	Chitkul Upgraded to USFDA.	Chitkul Upgraded to USFDA and UKMCA.	Pondicherry Discontinued

* Semi Synthetic Penicillin; Source: Company

Backward integration

APL has set up a 100% subsidiary Aurobindo (Datong) Biopharma to manufacture 6APA, a key raw material of the company. Backward integration will have dual effect:

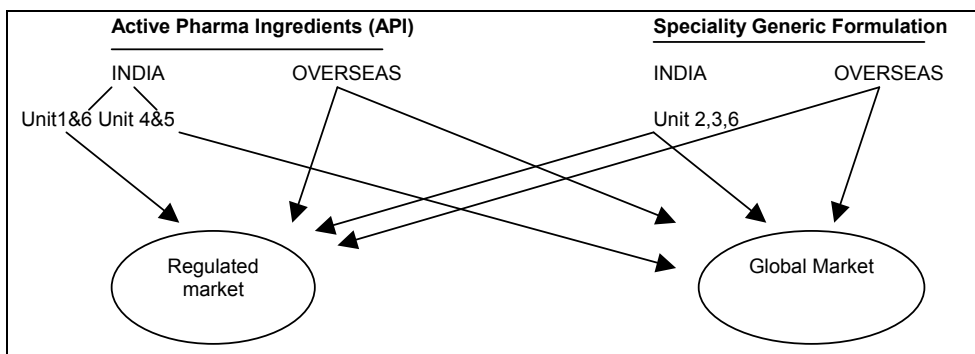
- The company would get assured supply of key raw materials
- It will be at a far more economical cost

There would be substantial savings in raw material costs resulting in better operating margins. APL will consume 40-50% of the total production and the rest would be sold in the local market.

Regulated market - The focus area

APL's future growth strategy includes gaining a dominant position in the formulated generics (regulated and non-regulated) markets. The company streamlined two bulk drugs and two of its formulation units to meet USFDA/UKMCA standards (USFDA audit is expected to take place in FY04). APL plans filing non-infringing processes in the regulated market with a focus on cardiovascular, anti-ulcer and the CNS segment. The company has filed 3 drug master files (DMFs) and is in the process of filing 12 more. We believe that the regulated market will start adding to APL's topline and bottomline only towards end of FY04, once the plants are USFDA approved.

Exhibit 2: Manufacturing facilities: Focus markets



Source: Karvy Stock Broking, Company

Approvals from developing market

For its formulations business, APL is targeting developing markets especially Brazil, China and South Africa. The company has received Brazilian CGMP certification for one of its formulation units (Unit 3). Brazil's generic market is one of the fastest growing in the world. During October-September'02, generic sales in Brazil grew by 45% (Source: IMS Health Data). APL has also received regulatory approval from MCC, South Africa, for two of its formulation units.

Improving product mix

APL's product mix has changed considerably towards *Cephalosporin* and high value-added bulk in the last two years. Contribution from semi-synthetic penicillin (SSP – bulk and sterile) has reduced radically from 50% of the total sales in FY00 to around 40% in FY02.

Exhibit 4: Key Products

Cephalosporin	Anti-ulcerant	Anti-fungal	Anti-depressant	Penicillin
Cefazolin Sodium	Omeprazole	Fluconazole	Citalopram HCL	Amoxicillin Sodium
Cefotaxim Sodium	Lansoprazole		Sertraline HCL	Ampicillin Sodium
Cefuroxime Sodium		Cardiovascular	Mirtazapine	Flucloxacillin Sodium
Cefprozil		Atorvastatin		
Cefuroxime Axetil		Lisinopril		
Cephalexin Sterile		Ramipril		
Ciprofloxacin HCL		Simvastatin		

Source: Company

Changeover to new generation, value-added drugs

SSP prices have been declining over the years, which was clearly apparent in APL's diminishing OPM levels. There has been substantial growth in new generation *Cephalosporin* (especially oral which has grown by 76% in FY00-02) and high value bulk drugs. We believe a better product mix in terms of new generation *Cephalosporin* and high value-added drugs will result in improved margins. In the 9 months ending FY03, *Cephalosporin* and high value bulk drugs contributed 38% and 8% respectively, to revenues as compared to 25% and 6% in FY00. We expect SSP and *Cephalosporin* sales to contribute 33.7% and 40.8% of revenues respectively, in FY04. Formulations to the non-regulated market have started picking up and we expect it to contribute 9% of the sales by FY04.

Exhibit 3: Product mix

Rs crore

	FY00	FY01	FY02	9mths FY03
SSP Bulk Drug	330.5	322.5	361.4	290.14
% of sales	44.3	32.4	34.8	34.0
Cephalosporin – Oral	89.5	162.0	157.7	169.67
% of sales	12.0	16.3	15.2	19.9
Quinolones	46.6	37.3	32.2	10.4
% of sales	6.3	3.7	3.1	1.2
High Value Bulk Drug	44.5	65.8	53.1	71.37
% of sales	6.0	6.6	5.1	8.4
SSP sterile	35.7	37.9	56.6	44.95
% of sales	4.8	3.8	5.5	5.3
Cephalosporin – sterile	95.3	115.8	162.6	157.59
% of sales	12.8	11.6	15.7	18.5
Formulation	27.1	51.2	87.3	47.21
% of sales	3.6	5.1	8.4	5.5
Others	76.5	203.1	126.7	62.32
% of sales	10.3	20.4	12.2	7.3
Total	745.6	995.5	1037.7	853.7

Source: Company

R&D: Focus on non-infringing process

The company's R&D department is primarily focused on identifying non-infringing process to foray into the regulated markets. Currently, there are around 175 personnel working with APL's R&D center. As mentioned earlier, the company has already filed 3 DMFs and is in the process of filing 12 more.

Joint Ventures – Route to growth in Overseas' markets

APL's strategy for the overseas market has been primarily entering in joint ventures (JV) with partners conversant with the local market. The company has entered into JVs in the two major markets of USA and China.

JV in USA

In the US, APL has set up a 50:50 JV with Geravi Inc., a subsidiary of Medpharmex, US, called Cephazone Pharma LLC. APL has invested US \$4mn in the JV, which will manufacture sterile and non-sterile *Cephalosporin*. The JV will also look at actively filing ANDAs for *Cephalosporin* drugs. Trial runs have commenced and production is expected to begin from April'03.

JV in China

APL has entered into a JV with Tongling Corporation of China for the manufacture of *Cephalosporin* drugs for the local and the European markets.

Domestic Formulation now through a JV

With APL focusing on the regulated market in the formulation business, it transferred its domestic formulation business to a JV. The company set up Citadel Aurobindo Biotech Limited, a 50:50 JV with the Citadel group for marketing of branded

formulation in the domestic market. APL received Rs100mn for the sale of branded formulation and Rs300mn as non-competence fees.

Risk

APL derives substantial revenues from bulk drugs especially SSP bulk which accounts for 34% of it's revenue. SSP prices have been declining continuously which has been affecting the company's operating margin. The company is now moving towards the formulation business, starting with the non-regulated markets. Going forward, we believe bulk drug contribution towards sales would decline substantially.

Financials

Strong revenue growth FY04 onwards

APL was in a state of “metamorphosis” for the last two years on account of the various restructuring measures undertaken by it. Following discontinuation of some of its plants and integration of some others, APL’s growth had lagged. However, we believe, with a major part of the restructuring exercise now over, the company will be on growth track. We expect APL’s sales to grow by 9.1% in FY03 and by 18% in FY04.

Thrust on high margin products

APL’s operating margins have been low in the past with majority of its sales coming from the low margin SSP business. However, the company’s management has been constantly making efforts to move towards high-margin products. For instance, new generation drug *Cephalosporin* contributed 38% of sales during April-December’03 up from 25% in FY00. The company has been concentrating on new generation *Cephalosporin* as the margins are relatively higher compared to older generation drugs.

Operational efficiencies to spur margins

We expect APL’s OPM to improve to 16.5% in FY04 from 12.2% in FY02 on the back of the following:

- Savings in overheads due to better integration. APL has discontinued some of its facilities and integrated some others with new ones. We believe this will lead to improved operational efficiencies and save substantially on overheads.
- APL’s raw material cost is also expected to decline. APL will now be sourcing one of its key raw materials 6APA from its China subsidiary at a lesser cost.
- Lastly, there has been a ranked improvement in APL’s product mix.

Capital expenditure completed

APL incurred capex of Rs1.7bn towards restructuring, enhancement and upgradation of its facilities. It has also discontinued some units. For instance, APL’s Pondicherry and Bolaram (Unit 2) plants were discontinued and integrated with its Vizag plant – spread over 82 acres, has 12 blocks for bulk intermediates, of which 3 are operational. The company is also setting up a new formulation facility at a total cost of Rs150mn.

Exhibit 5: Total Capex	Rs Million
Vizag Plant	900
New Formulation Unit	150
Unit 6 Upgradation	220
Sri Chakra plant Upgradation	420

Source: Company

Majority of APL’s capex is over except the new formulation unit, which would be completed in Q3FY04. Apart from capex, the company also invested in its wholly owned subsidiary and the joint ventures in China and USA.

Means of finance

APL made a preferential allotment to M/s Templeton Strategic Emerging Market Fund LDC and promoters in April 2002. Two million equity shares (1mn each to Templeton and promoters) and as many number of warrants at a premium of Rs216 per share were issued. Templeton converted the warrants into underlying equity shares in September 2002.

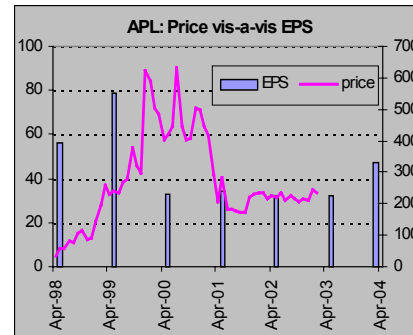
View and Valuation

We expect APL to clock robust growth FY04 onwards. In FY04, APL's sales would improve by 18% and PAT would grow by 53.4%. Growth in PAT will primarily be driven by growth at the operating level. We estimate the company to clock an EPS of Rs32.2 in FY03 and Rs47.4 in FY04.

Exhibit 6: PE Multiple



Exhibit 7: Price Vs. EPS



APL has been hovering in the Rs200-250 range since April 2001. The company has been recording flat sales and net profit in the last two years primarily on account of the restructuring exercise. As a result, at the bourses the stock too moved in the narrow band. We believe APL is headed for growth FY04 onwards and that the stock is in for a strong re-rating.

At current levels, APL is trading at a lower band of 4.7x FY04E earnings. Historically, the stock has been trading at around 4.5-7x forward earnings. We expect the stock to command a forward multiple of 6.5x on FY04 earnings (based on an average 1-year forward PE) on the back of strong growth from that year onwards. We recommend a **Buy** on the stock with a 1-year target price of Rs310.

Profit & Loss Account

Rs Million

Year End March 31	FY01	FY02	FY03E	FY04E
Revenues	9,961.0	10,377.2	11,326.5	13,365.4
<i>% chng</i>		4.2	9.1	18.0
Less: Excise Expense	541.9	640.3	679.6	801.9
	8,149.9	8,504.6	9,108.3	10,362.2
EBITDA	1,269.2	1,232.3	1,538.6	2,201.3
<i>% chng</i>		(2.9)	24.9	43.1
EBITDA %	12.7	11.9	13.6	16.5
Other Income	63.1	215.8	95.0	125.0
Depreciation	147.8	158.1	226.0	338.8
PBIT	1,184.5	1,290.0	1,407.6	1,987.5
Interest	416.8	423.9	434.7	514.6
PBT	767.7	866.1	972.9	1,472.8
Tax	151.2	203.3	223.8	324.0
PAT	616.5	662.8	749.1	1,148.8
<i>% chng</i>		7.5	13.0	53.4
Shares outstanding	20.0	20.7	23.3	24.3
EPS (Rs)	30.8	32.1	32.2	47.4

Key Ratios

	FY01	FY02	FY03E	FY04E
OPM(%)	12.7	11.9	13.6	16.5
Avg. RoCE (%)	27.5	21.5	17.5	20.1
Avg. RoNW (%)	25.3	20.8	17.6	21.2
Inventory Days	67.0	47.0	45.0	50.0
Debtors Days	73.8	129.3	110.0	120.0
EV/EBITDA	5.9	7.0	6.1	4.5
EV/Sales	0.8	0.8	0.8	0.7
Asset Turnover	4.4	3.0	2.6	2.8
Debt Equity (x)	0.8	0.9	0.8	0.8
PE(x)	7.5	7.2	7.1	5.0
P/CEPS	6.0	5.8	5.5	3.8
PBV (Rs)	1.7	1.3	1.1	0.9

Balance Sheet

Rs Million

Year End March 31	FY01	FY02	FY03E	FY04E
Liabilities				
Share Capital	200.0	206.7	232.5	242.5
Reserve & Surplus	2,564.2	3,406.9	4,643.5	5,695.3
Net worth	2,764.2	3,613.6	4,876.0	5,937.8
Loans	2,259.0	3,360.0	4,200.0	4,750.0
Capital Employed	5,023.2	6,973.6	9,076.0	10,687.8
Asset				
Gross Block	1,981.9	2,191.2	4,000.0	4,800.0
Acc. Depreciation	375.9	490.5	716.5	1,055.3
Net Block	1,606.0	1,700.7	3,283.5	3,744.7
WIP	108.6	559.6	600.0	300.0
Investments	247.5	737.3	1,500.0	1,800.0
Current Asset				
Inventory	1,729.9	1,254.6	1,396.4	1,830.9
Debtors	2,013.0	3,675.7	3,713.5	4,394.1
Cash & Bank	45.5	111.3	97.5	374.6
Loans and Advances	303.5	384.3	434.4	659.1
Other current asset	338.3	353.6	372.4	549.3
Less:				
Current Liability	1,281.2	1,467.6	1,871.6	2,271.2
Provision	87.9	120.6	150.0	300.0
Deferred Tax Lia.	-	221.1	300.0	393.0
Capital Employed	5,023.2	6,973.6	9,076.0	10,687.8

Stock Ratings Absolute Returns

Buy	:	> 25%
Out Performer	:	16 - 25%
Market Performer	:	0 - 15%
Under Performer	:	< 0%

Karvy Stock Broking Limited

131, Andheri Industrial Estate, Off Veera Desai Road, Andheri (W), Mumbai – 400 053. India.
Voice: (91-22) 5695 0204 - 7, 5693 6346 /47.

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Karvy Stock Broking Team

Research Desk (Tel: 91-22-56936346 / 47)

Analyst	Sector	E-mail address
Amit Adesara	Mid-caps	amit.adesara@karvy.com
Amol Dhariya	Media & Telecom	amol.dhariya@karvy.com
Apoorva Zinzuvadia	Information Technology	apoorva@karvy.com
Devang Visaria	Technical Analyst	devang.visaria@karvy.com
Sumeet Pillai	Automobile & Mid Caps	sumeetpillai@karvy.com
Urmik Chhaya	Cement, Engg, Capital Goods & Power	urmik.chhaya@karvy.com

Institutional Business Group

Vikrant Oak
131, Andheri Industrial Estate,
Off Veera Desai Road,
Andheri (W) Mumbai-400053
Tel: 91-22-56974339, 56950205
vikrant.oak@karvy.com

Private Client Group

Mumbai
Yogesh Kalwani
Tel: 91-22-26730757, 26730252
yogesh.kalwani@karvy.com

Kolkata
Suvankar Chakravarty
Tel: 91-33-24655049/51
suvankarc@karvy.com

Bangalore
Manoj Shenoy
Tel: 91-80-2201285/2202107/08
manoj@karvy.com

New Delhi
Bidyut Chowdhury
Tel: 91-11-23324401
bidyut@karvy.com

Pune
Rajesh Sharma
Tel: 91-20-5513356
rksharma@karvy.com

Branches

Ahmedabad	Jayesh Patel, 079-6420422/6400527/28; jayesh@karvy.com
Bangalore	PB Ramapriyan, 080-6621184, ramapriyanpb@karvy.com
Baroda	Shobhan Doshi, 0265-364469, 0265-362622; shobhan@karvy.com
Belgaum	Abhijit Lurkumbi, 0831-402722; ksblbelgaum@karvy.com
Bhimavaram	P Prabhakar Varma, 08816-23766/69; ppvarma@karvy.com
Bhubaneshwar	GS Swaminath; 0674-539287/539387/532804, swami@karvy.com
Chennai	Alexander Cherian; 044-8151034/8151034, alexc@karvy.com
Coimbatore	S Ramachandran; 0422-237501-502/237506, sm@karvy.com
Guntur	S Shrikanth; 0863-2326684/326686; ssrikanth@karvy.com
Hubli	Basavaraj Hirur; 0836-353961/62/63/73, basavarajhirur@karvy.com
Hyderabad	Muktesh Sharma; 040-6510075/6510399/3402241, muktesh@karvy.com
Indore	Pankaj Mungre, 0731-269891/92/93; pmungre@karvy.com
Kolkata	Alok Chaturvedi; 033-44891/7231/4634788, alokc@karvy.com
Mangalore	Pravin Salian; 0824-92302/496332/496352; pravinsalian@karvy.com
Mumbai	Satish Pasari; 022-2062023/27/42/87, satishp@karvy.com
Mysore	S Sudhir; 0821-524292/524293, sudhirs@karvy.com
New Delhi	Sakul Puri; 3353835/3353981, sakulpuri@karvy.com
Pondicherry	Vipul Hindocha; 220633/220644, vipul@karvy.com
Pune	Ajay Bhaskar, 91-20-5530204/5; abhaskar@karvy.com
Rajmundry	A Ramprasad, 0883-2434468/69; ramprasad@karvy.com
Shimoga	Vasanth Hoblidar; 0818-228795/96/97, vasanthoblidar@karvy.com
Surat	Harish Pillai; 0261-2369928, 2351976; hbp@karvy.com
Udupi	Nanda Kumar; 08252-530962/63/64, nandakumar@karvy.com
Vijayawada	C Chalapathi Rao; 0866-436965/436128, cchrao@karvy.com
Vishakapatnam	VV Gopal; 0891-752915 to 18, vvgopal@karvy.com

Regd Off: Karvy Stock Broking Limited, 46, Road No 4, Street No 1, Banjara Hills, Hyderabad – 500 034. Tel: 040-23351988, 23354283.