

9 August 2019

Natco Pharma

Strong pipeline, valuation appealing; maintaining a Buy

With niche product launches, Natco's India, Brazil and Canada businesses would do well, we believe. However, its revenue, EBITDA and PAT are likely to be flat over FY19-21 due to the high base for gTamiflu, though to some extent likely to be counter-balanced by gCopaxone. Beyond FY21, however, we expect a few niche launches to drive earnings. We retain a Buy on the stock, with a target of ₹763.

Subdued domestic formulations, likely to recover however. In Q1 FY20 Natco's domestic formulations revenue declined 14% y/y to ₹1.6bn, mainly due to the drag in Hep C sales and stock adjustments in its domestic oncology range. However, to some extent, revenues benefited from good domestic launches. The six brands (Veenat, Lenalid, Erlonat, Gefinat, Sorafenat and Bortentat) in oncology had sales of over ₹100m. The company is focusing on niche molecules with high entry barriers, with 6-8 targeted launches yearly. We expect value unlocking in the near future with existing and other molecules in the pipeline. We believe domestic-formulations growth would be driven by oncology and CnD, and expect a ~14% revenue CAGR over FY19-21.

Focus on complex generics, the key. In Q1 FY20 gCopaxone gained market share to ~33%; though it saw price erosion, overall revenue was higher. We believe gCopaxone would drive Natco's FY20 earnings till Dec'19 on competitors' delayed entry into generics. Post-FY20, its focus on Canada and Brazil with limited-competition launches would drive revenue growth. A few key launches in the US (gTarkeva, gZytiga, gEliquis) would offset some losses from gCopaxone, expected then to be under pressure from generic competition. Its next big launches could be gRevlimid (Mar'22), Afinitor (Everolimus) and Nexavar (Sorafenib), post-FY21. Besides, in Jan'19, it filed an ANDA (sole-filer status) for Ibrutinib in the US (J&J's Imbruvia, a \$2.6bn market) along with its partner, Alvogen.

Valuation. We retain our Buy call with a target of ₹763, based on a sum-of-parts method. **Risks:** Currency fluctuations, delay in approvals.

Key financials (YE Mar)	FY17	FY18	FY19	FY20e	FY21e
Sales (₹ m)	20,650	22,020	20,945	22,776	21,825
Net profit (₹ m)	4,860	6,962	6,444	6,950	6,328
EPS (₹)	26.3	37.7	35.3	38.2	34.8
PE (x)	32.2	20.0	15.6	14.5	15.9
EV / EBITDA (x)	22.8	14.7	12.6	11.2	11.7
PBV (x)	9.3	4.5	2.9	2.5	2.2
RoE (%)	33.0	29.5	19.6	18.4	14.6
RoCE (%)	30.1	27.5	18.4	17.0	13.7
Dividend yield (%)	0.8	1.1	3.0	1.0	0.9
Net debt/equity (x)	0.1	-0.0	-0.0	-0.1	-0.1

Source: Company, Anand Rathi Research

Rating: **Buy**

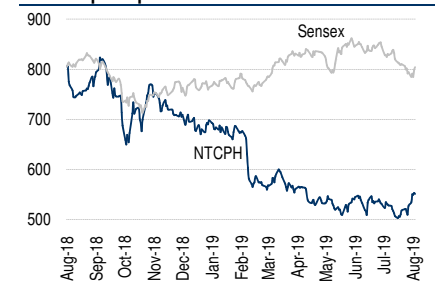
Target Price: ₹763

Share Price: ₹552

Key data	NATCPH IN / NATP.BO
52-week high / low	₹849 / 480
Sensex / Nifty	37582 / 11110
3-m average volume	\$1.8m
Market cap	₹100bn / \$1415.9m
Shares outstanding	182m

Shareholding pattern (%)	Jun'19	Mar '19	Dec '18
Promoters	49.0	48.7	48.42
- of which, Pledged	-	-	-
Free float	51.0	51.3	51.6
- Foreign institutions	20.1	21.4	23.8
- Domestic institutions	8.1	7.1	6.1
- Public	22.8	22.8	21.7

Relative price performance



Source: Bloomberg

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Quick Glance – Consolidated Financials and Valuations

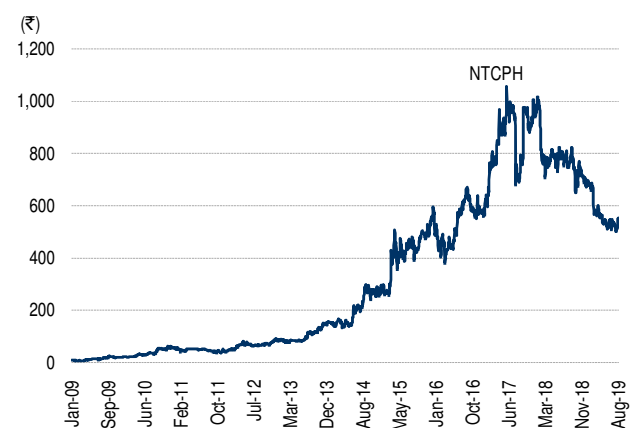
Fig 1 – Income statement (₹m)

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Net revenues	20,650	22,020	20,945	22,776	21,825
Growth (%)	91.2	6.6	-4.9	8.7	-4.2
Direct costs	5,991	4,111	3,542	4,100	4,365
SG&A	7,825	8,625	9,455	9,953	9,385
EBITDA	6,834	9,284	7,948	8,723	8,075
EBITDA margins (%)	33.1	42.2	37.9	38.3	37.0
- Depreciation	544	662	810	962	1,127
Other income	139	404	1,302	1,315	1,328
Interest expenses	185	154	193	192	189
PBT	6,244	8,872	8,247	8,884	8,087
Effective tax rate (%)	22.3	21.6	22.1	22.0	22.0
+ Associates / (Minorities)	-11	-10	-20	-20	-20
Net income	4,860	6,962	6,444	6,950	6,328
Adjusted income	4,860	6,962	6,444	6,950	6,328
WANS	185	185	183	182	182
FDEPS (₹/ sh)	26.3	37.7	35.3	38.2	34.8

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
PBT (Adj. other income/ interest)	6,290	8,622	7,138	7,761	6,948
+ Non-cash items	544	662	810	962	1,127
Oper. prof. before WC	6,834	9,284	7,948	8,723	8,075
- Incr./(decr.) in WC	2,141	8,516	717	734	-357
Others incl. taxes	1,394	2,199	1,883	1,954	1,779
Operating cash-flow	3,299	-1,431	5,348	6,034	6,653
- Capex (tang. +intang.)	3,018	3,955	4,472	3,625	3,625
Free cash-flow	281	-5,386	876	2,409	3,028
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	1,418	1,830	3,383	1,170	1,065
+ Equity raised	-	9,150	-4	-1	-
+ Debt raised	1,090	-484	2,131	-50	-50
- Fin investments	100	443	921	149	164
- Misc. (CFI + CFF)	(53)	(472)	(2,259)	(1,143)	(1,159)
Net cash-flow	-94	1,479	958	2,183	2,908

Source: Company, Anand Rathi Research

Fig 5 – Price movement


Source: Bloomberg

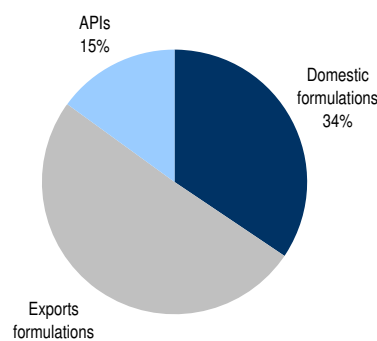
Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Share capital	349	369	365	364	364
Net worth	16,493	30,722	34,890	40,669	45,932
Debt	2,216	1,732	3,863	3,813	3,763
Minority interest	41	38	20	20	20
DTL/(Assets)	150	139	116	116	116
Capital employed	18,900	32,631	38,889	44,618	49,831
Net tangible assets	8,272	10,127	12,185	14,723	17,096
Net intangible assets	58	59	87	92	97
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	3,363	4,800	6,376	6,496	6,616
Investments (strategic)	-	-	-	-	-
Investments (financial)	322	765	1,686	1,835	1,998
Current assets (ex cash)	10,803	19,563	19,902	20,886	20,497
Cash	358	1,837	2,795	4,978	7,886
Current liabilities	4,276	4,520	4,142	4,392	4,360
Working capital	6,527	15,043	15,760	16,494	16,137
Capital deployed	18,900	32,631	38,889	44,618	49,831
Contingent liabilities	632	1,080	781	-	-

Fig 4 – Ratio analysis

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
P/E (x)	32.2	20.0	15.6	14.5	15.9
EV / EBITDA (x)	22.8	14.7	12.6	11.2	11.7
EV / Sales (x)	7.5	6.2	4.8	4.3	4.3
P/B (x)	9.3	4.5	2.9	2.5	2.2
RoE (%)	33.0	29.5	19.6	18.4	14.6
RoCE (%) - after tax	30.1	27.5	18.4	17.0	13.7
ANDA filings	43.0	46.0	50.0	-	-
DPS (₹ / sh)	6.8	8.3	17.3	5.3	4.9
Dividend yield (%)	0.8	1.1	3.0	1.0	0.9
Dividend payout (%) - incl. DDT	29.2	26.3	52.5	16.8	16.8
Net debt / equity (x)	0.1	-0.0	-0.0	-0.1	-0.1
Receivables (days)	84	106	88	88	88
Inventory (days)	62	73	92	92	92
Payables (days)	46	45	38	38	38
CFO : PAT %	67.9	-20.6	83.0	86.8	105.1

Source: Company, Anand Rathi Research

Fig 6 – Revenue break-up (Q1FY20)


Source: Company

Result highlights

Fig 7 – Quarterly financials (₹m)

Quarterly results (YE Mar)	Q3 FY17	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	% Y/Y	% Q/Q
Sales	6,790	5,778	4,453	4,267	5,622	7,678	5,386	5,435	5,567	4,557	4,923	(8.6)	8.0
Gross profit	4,644	4,606	3,359	3,138	4,964	6,448	4,513	4,486	4,517	3,887	4,163	(7.8)	7.1
Gross margins (%)	68.4	79.7	75.4	73.5	88.3	84.0	83.8	82.5	81.1	85.3	84.6	77bps	-74bps
EBITDA	2,602	2,411	1,367	1,219	2,865	3,833	2,176	2,205	2,084	1,483	1,913	(12.1)	29.0
EBITDA margins (%)	38.3	41.7	30.7	28.6	51.0	49.9	40.4	40.6	37.4	32.5	38.9	-154bps	632bps
Interest	46	64	39	42	43	30	28	50	63	52	65	132.1	25.0
Depreciation	137	135	150	160	172	180	184	202	207	217	220	19.6	1.4
Other income	61	(6)	34	55	114	201	359	400	233	310	210	(41.5)	(32.3)
PBT	2,480	2,206	1,212	1,072	2,764	3,824	2,323	2,353	2,047	1,524	1,838	(20.9)	20.6
Tax	512	498	266	235	590	1,108	648	550	515	170	410	(36.7)	141.2
Effective tax rate (%)	21.4	20.0	22.7	21.3	21.3	21.6	22.0	22.8	22.2	21.0	22.3	27bps	131bps
Adjusted PAT	1,952	1,767	940	848	2,175	2,999	1,816	1,825	1,595	1,208	1,432	(21.1)	18.5

Source: Company, Anand Rathi Research

Fig 8 – Quarterly financials (₹ m)

Quarterly results (YE Mar)	Q3 FY17	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	% Y/Y	% Q/Q
APIs	507	560	863	584	811	597	670	668	990	702	720	7.5	2.6
Formulations	5,797	5,070	3,160	3,403	4,199	6,505	4,270	4,418	4,200	3,312	4,050	(5.2)	22.3
Domestic oncology	883	840	731	973	848	828	910	982	930	1,148	1,100	20.9	(4.2)
Exports	3,609	2,890	1,338	1,268	2,540	4,920	2,360	2,478	2,570	1,442	2,410	2.1	67.2
Other domestic	1,306	1,340	1,091	1,162	811	757	1,000	957	700	723	540	(46.0)	(25.3)
Total Revenue	6,305	5,630	4,023	3,987	5,010	7,102	4,940	5,086	5,190	4,014	4,770	(3.4)	18.8

Source: Company, Anand Rathi Research

Concall highlights and Key takeaways

- Domestic formulations revenue in Q1 FY20: ₹1.64bn (oncology ₹800m, other domestic ₹310m, CnD ₹300m and third-party ₹230m).
- Revenue from Hep-C business: ₹310m.
- International subsidiary sales: ₹280m.
- Growth in the oncology segment was impacted on account of a one-time fall in inventory and a slowdown in one of its brands.
- Capex ₹600m. Capex guidance for FY20: ₹3.5bn-4bn for the Vizag plant (₹150m-200m), API unit in Hyderabad, new agrochemical plant at Nellore, expanding oncology and for the injectables plant.
- Management said in gCopaxone, Mylan's market share is 33%, however, it saw price erosion but its contribution to sales and operating profit has increased.
- Growth in the Indian business is likely to be driven by oncology and the cardio-diabetics segments. The Hep-C business has now stabilised.
- Natco has replied to the US FDA queries on Revlimid and expects to receive approval in the next few months. For Revlimid, it has a First-to-File status. It has settled with the innovator for a 2022 launch. The tablet line for this product is ready.
- In Brazil and Canada, it expects 3-4 limited-competition launches in FY20.
- During Q1 it launched 2-3 products in India.

- It has received EIR for the Kothur plant.

Fig 9 – Sales break-up assumptions

Particulars (₹ m)	FY19	FY20e	FY21e
Domestic formulations	7,350	8,311	9,445
% of Sales	38.2	39.8	47.8
% Y/Y	2.1	13.1	13.6
Export formulations	8,850	9,350	6,852
% of Sales	46.0	44.7	34.7
% Y/Y	(15.0)	5.6	(26.7)
API	3,030	3,242	3,469
% of Sales	15.8	15.5	17.6
% Y/Y	6.2	7.0	7.0
Total	19,230	20,903	19,766

Source: Company, Anand Rathi Research

Fig 10 – Para IV opportunities

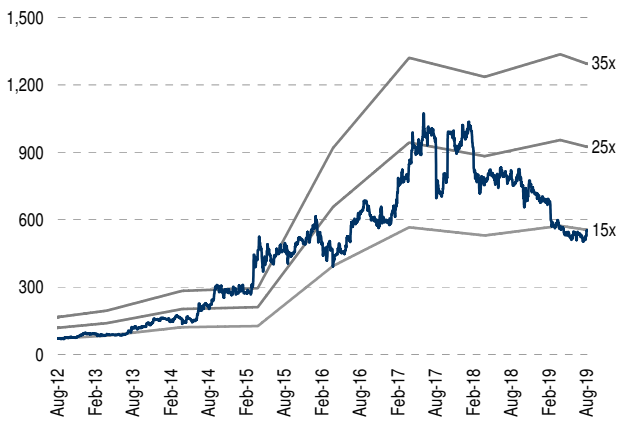
Key brand	Molecule	Therapeutic segment /indication	Para IV
Nexavar	Sorafenib	Liver, Kidney Cancer	✓
Tykerb	Lapatinib Ditosylate	Cancer	✓
Revlimid	Lenalidomide	Multiple Myeloma	✓
Afinitor	Everolimus (higher strength)	Kidney Cancer	✓
Zytiga	Abiraterone	Prostate Cancer	✓
Aubagio	Teriflunomide	Multiple Sclerosis, CNS	✓
Tarceva	Erlotinib	NSCLC, Pancreatic Cancer	✓
Kyprolis	Carfilzomib	Multiple Myeloma	✓
Eliquis	Apixaban	Anticoagulant	✓
Pomalyst	Pomalidomide	Multiple Myeloma	✓
Sovaldi	Sofosbuvir	Anti-Viral / Hep C	✓
Ibruvica	Ibrutinib	Cancer	✓

Source: Company

Valuations

At the CMP of ₹552, the stock trades at 14.5x and 15.9x respective FY20e and FY21e earnings. We retain our Buy recommendation with a price target of ₹763, based on a sum-of-parts method. We value the base business at ₹626, based on 18x FY21 earnings and value the Para-IV opportunity at ₹137.

Fig 11 – PE Band – one-year-forward



Source: Bloomberg, Anand Rathi Research

Fig 12 – Standard deviation – one-year-forward



Source: Bloomberg, Anand Rathi Research

Risks

- Currency fluctuations
- Regulatory hurdles
- Delay in approval of Para-IV products.

Fig 13 – Key data

	RATING	CMP (₹)	TP (₹)	M Cap (₹ bn)	PE (x)		PE (x) Bloomberg		EV / EBITDA		RoE (%)		RoCE (%)	
					FY20e	FY21e	FY20e	FY21e	FY20e	FY21e	FY20e	FY21e	FY20e	FY21e
Aarti	Buy	463	796	10.9	9.1	7.0	10.0	8.2	6.1	5.0	20.1	21.4	12.6	14.3
Ajanta	Hold	946	1,057	84.0	19.8	16.3	20.3	17.0	13.1	10.9	17.6	18.6	17.3	18.2
Alembic	Hold	531	555	100.0	18.2	16.9	18.3	16.8	12.5	11.0	18.4	17.3	14.1	13.8
Alkem	Buy	1737	2089	207.6	21.7	17.5	22.1	17.7	15.0	12.1	16.5	18.2	16.7	18.4
Cadila	Hold	227	291	232.3	14.3	13.3	14.0	12.8	10.0	9.1	14.8	14.4	9.5	9.7
Dishman	Buy	208	390	33.6	10.1	8.5	12.7	10.4	6.5	5.5	16.4	17.3	11.7	12.7
Eris	Buy	401	614	55.1	15.6	13.1	15.0	13.1	12.1	9.5	26.7	24.6	29.0	27.2
Granules India	Buy	91	167	23.1	8.0	6.5	8.5	7.3	5.8	4.6	17.5	18.2	10.1	11.2
Indoco Remedies	Buy	151	198	13.9	20.6	13.8	27.7	15.6	9.3	7.4	9.9	13.5	8.9	11.6
Ipca Labs.	Buy	931	1,091	117.6	20.9	17.1	21.2	17.1	13.2	10.8	16.7	17.4	14.6	15.6
JB Chemicals	Buy	366	455	29.4	12.7	11.3	13.1	11.5	7.0	6.1	15.1	15.7	14.5	15.1
Natco Pharma	Buy	549	761	101.1	14.4	15.8	15.6	16.0	11.2	11.8	18.4	14.6	17.0	13.7
Neuland	Buy	456	725	5.9	12.6	9.4	12.2	8.0	7.4	6.0	6.5	8.1	6.1	7.4
Pfizer	Hold	2940	3265	134.5	29.3	25.2	26.7	23.6	17.6	15.0	14.5	15.2	14.5	15.2
Suven Life Sciences	Hold	229	286	29.2	25.5	24.4	22.9	19.2	15.2	14.0	13.1	12.4	12.2	11.6
Torrent Pharma	Hold	1,701	1,761	287.8	33.1	25.1	32.5	24.8	14.8	12.6	17.5	20.7	12.2	15.8
HCG	Buy	107	213	9.4	NM	302.7	NM	73.4	9.9	7.7	NM	0.7	3.7	5.3

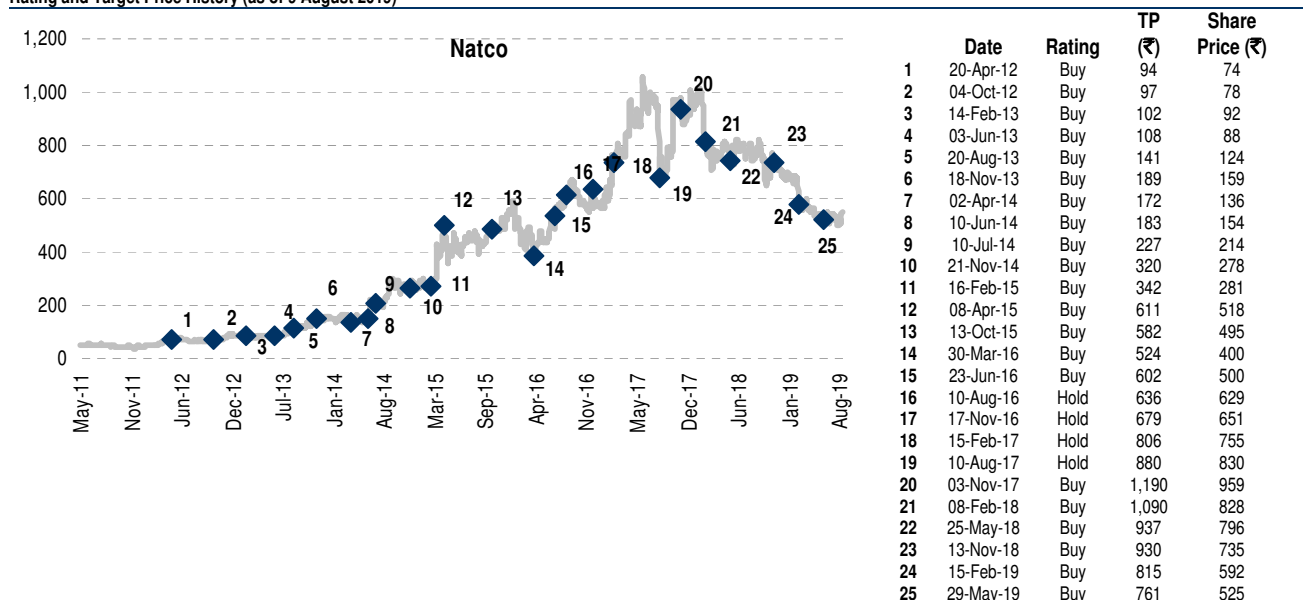
Source: Company, Anand Rathi Research

Appendix

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