

13 November 2019

Natco Pharma

*Focus on key filings; maintaining a Buy*Rating: **Buy**

Target Price: ₹729

Share Price: ₹561

Despite Natco's earnings expected to decline over FY19-21 on gTamiflu's high base, we believe this is likely to be counter-balanced to some extent by the gCopaxone ramp-up in the US. However, beyond FY21, the strong contribution from key launches in India, Brazil and Canada would drive earnings growth. Thus, we retain our Buy, with a lower target of ₹729 (earlier ₹763).

Weak quarter for domestic formulations. Natco's Q2 FY20 domestic formulations revenue slid 37% y/y to ₹1.2bn, mainly due to the drag in Hep C sales and in its domestic oncology range, on pricing pressure in its two big brands. However, it is focusing on niche molecules with high entry barriers, aiming at 6-8 launches yearly. It recently launched Eribulin in oncology and expects value unlocking in the near future with existing molecules and others in the pipeline. We expect a ~5% revenue CAGR over FY19-21.

Focus on complex generics, the key. Its market share in gCopaxone is ~30-35%, and gCopaxone and gDoxil revenue was stable q/q. 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 in gCopaxone, expected then to be under pressure from competition in generics. Its next big launches could be gRevlimid (Mar'22), Afinitor (Everolimus) and Nexavar (Sorafenib), post-FY21. Besides, in Jan'19, with its partner, Alvogen, it filed an ANDA (sole-filer status) for Ibrutinib in the US (J&J's Imbruvia, a \$2.6bn market).

Change in estimates. Post-Q2 FY20, considering the lower-than-expected domestic formulations revenue we cut our FY20e/FY21e revenue 7%/11%; and factoring in the lower gross margin, we cut our EBITDA estimates 15% and 19% respectively and PAT 14.8% and 19%.

Valuation. We retain our Buy call with a lower target of ₹729, based on a sum-of-parts calculation. **Risks:** Currency fluctuations, delay in approvals.

Key financials (YE Mar)	FY17	FY18	FY19	FY20e	FY21e
Sales (₹ m)	20,650	22,020	20,945	21,250	19,419
Net profit (₹ m)	4,860	6,962	6,444	5,923	5,117
EPS (₹)	26.3	37.7	35.3	32.5	28.1
PE (x)	32.2	20.0	15.9	17.2	19.9
EV / EBITDA (x)	22.8	14.7	12.8	13.4	14.8
PBV (x)	9.3	4.5	2.9	2.6	2.3
RoE (%)	33.0	29.5	19.6	15.9	12.2
RoCE (%)	30.1	27.5	18.4	14.7	11.5
Dividend yield (%)	0.8	1.1	3.0	0.8	0.7
Net debt / equity (x)	0.1	-0.0	-0.0	-0.1	-0.1

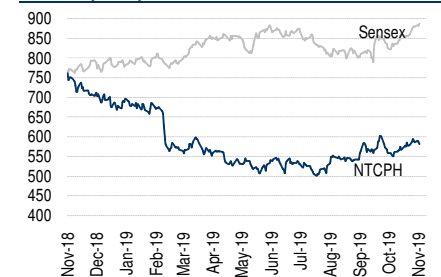
Source: Company, Anand Rathi Research

Key data	NTCPH IN / NATP.BO
52-week high / low	₹754 / 480
Sensex / Nifty	40116 / 11840
3-m average volume	\$1.4m
Market cap	₹102bn / \$1413.9m
Shares outstanding	182m

Shareholding pattern (%)	Sep'19	Jun'19	Mar'19
Promoters	49.0	49.0	48.7
- of which, Pledged	-	-	-
Free float	51.0	51.0	51.3
- Foreign institutions	21.6	20.1	21.4
- Domestic institutions	9.0	8.1	7.1
- Public	20.5	22.8	22.8

Estimates revision (%)	FY20e	FY21e
Sales	(6.7)	(11.0)
EBITDA	(15.0)	(19.2)
EPS	(14.8)	(19.1)

Relative price performance



Source: Bloomberg

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Quick Glance – Consolidated Financials and Valuations

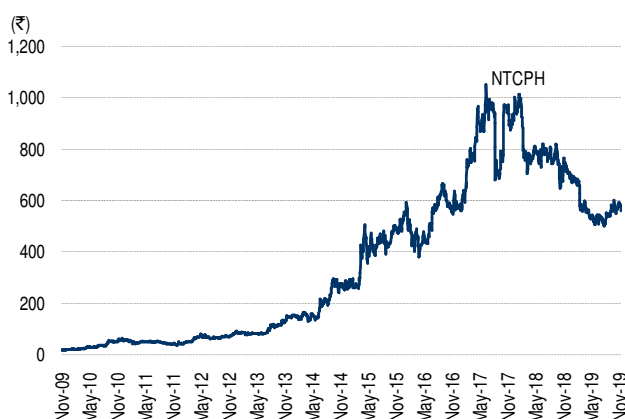
Fig 1 – Income statement (₹ m)

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Net revenues	20,650	22,020	20,945	21,250	19,419
Growth (%)	91.2	6.6	-4.9	1.5	-8.6
Direct costs	5,991	4,111	3,542	3,825	3,884
SG&A	7,825	8,625	9,455	10,009	9,011
EBITDA	6,834	9,284	7,948	7,416	6,525
EBITDA margins (%)	33.1	42.2	37.9	34.9	33.6
- Depreciation	544	662	810	921	1,078
Other income	139	404	1,302	1,315	1,328
Interest expenses	185	154	193	249	246
PBT	6,244	8,872	8,247	7,561	6,529
Effective tax rate (%)	22.3	21.6	22.1	22.0	22.0
+ Associates / (Minorities)	-11	-10	-20	-25	-25
Net income	4,860	6,962	6,444	5,923	5,117
Adjusted income	4,860	6,962	6,444	5,923	5,117
WANS	185	185	183	182	182
FDEPS (₹/ sh)	26.3	37.7	35.3	32.5	28.1

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	6,495	5,447
+ Non-cash items	544	662	810	921	1,078
Oper. prof. before WC	6,834	9,284	7,948	7,416	6,525
- Incr. / (decr.) in WC	2,141	8,516	717	34	-675
Others incl. taxes	1,394	2,199	1,883	1,663	1,436
Operating cash-flow	3,299	-1,431	5,348	5,718	5,764
- Capex (tang. + intang.)	3,018	3,955	4,472	3,625	3,625
Free cash-flow	281	-5,386	876	2,093	2,139
Acquisitions					
- Div. (incl. buyback & taxes)	1,418	1,830	3,383	997	861
+ 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)	(1,091)	(1,107)
Net cash-flow	-94	1,479	958	1,987	2,171

Source: Company, Anand Rathi Research

Fig 5 – Price movement


Source: Bloomberg

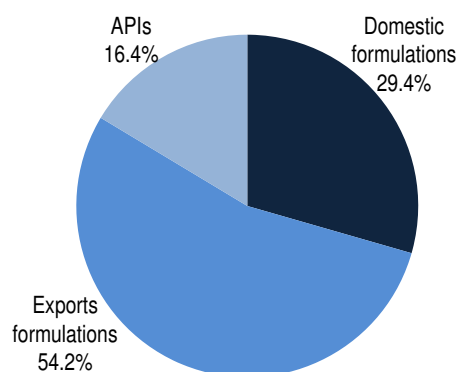
Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Share capital	349	369	365	364	364
Net worth	16,493	30,722	34,890	39,815	44,071
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	43,764	47,970
Net tangible assets	8,272	10,127	12,185	14,764	17,186
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	20,120	19,289
Cash	358	1,837	2,795	4,782	6,953
Current liabilities	4,276	4,520	4,142	4,325	4,170
Working capital	6,527	15,043	15,760	15,794	15,119
Capital deployed	18,900	32,631	38,889	43,764	47,970
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	15.9	17.2	19.9
EV / EBITDA (x)	22.8	14.7	12.8	13.4	14.8
EV / Sales (x)	7.5	6.2	4.8	4.7	5.0
P/B (x)	9.3	4.5	2.9	2.6	2.3
RoE (%)	33.0	29.5	19.6	15.9	12.2
RoCE (%) - after tax	30.1	27.5	18.4	14.7	11.5
ANDA filings	43.0	46.0	50.0	-	-
DPS (₹ / sh)	6.8	8.3	17.3	4.6	3.9
Dividend yield (%)	0.8	1.1	3.0	0.8	0.7
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	40	41
CFO : PAT %	67.9	-20.6	83.0	96.6	112.6

Source: Company, Anand Rathi Research

Fig 6 – Revenue break-up (Q2 FY20)


Source: Company

Result highlights

Fig 7 – Quarterly financials (₹ m)

Quarterly results (YE Mar)	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 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)	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	% Y/Y	% Q/Q
APIs	507	560	863	584	811	597	670	668	990	391	720	7.5	84.1
Formulations	5,797	5,070	3,160	3,403	4,199	6,505	4,270	4,418	4,200	3,251	4,050	(5.2)	24.6
Domestic oncology	883	840	731	973	848	828	910	982	930	1,146	1,100	20.9	(4.0)
Exports	3,609	2,890	1,338	1,268	2,540	4,920	2,360	2,478	2,570	1,383	2,410	2.1	74.3
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	3,642	4,770	(3.4)	31.0

Source: Company, Anand Rathi Research

Concall highlights and Key takeaways

- Domestic formulations revenue in Q2 FY20: ₹1.22bn (oncology ₹680m, other domestic ₹340m, CnD ₹50m and third-party ₹150m).
- Revenue from the Hep-C business: ₹210m.
- International subsidiary sales: ₹270m.
- Growth in the oncology segment was impacted by the slowdown in two of its major brands
- The gross margin for the quarter declined on the slowdown in its domestic business and an gTamiflu inventory build-up for the flu season. (formulations and API stocking of respectively ₹300m and ₹250m).
- 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.
- Natco has filed for three oncology products in China and expects six filings in FY20.
- It has filed for agrochemical product CTPR (chlorantraniliprole), used in several crops and currently in litigation in India. The present market size is ₹1.54bn.
- In Brazil and Canada, it expects 3-4 limited-competition launches in FY20.

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	Anticoagulants	✓
Pomalyst	Pomalidomide	Multiple myeloma	✓
Sovaldi	Sofosbuvir	Anti-viral / Hep C	✓
Ibruvica	Ibrutinib	Cancer	✓

Source: Company

Valuations

Post-Q2 FY20, considering the lower-than-expected revenue in domestic formulations we cut our FY20e and FY21e revenue respectively 7% and 11% and, factoring in the lower gross margin we cut our EBITDA estimates 15% and 19% respectively and PAT 14.8% and 19%.

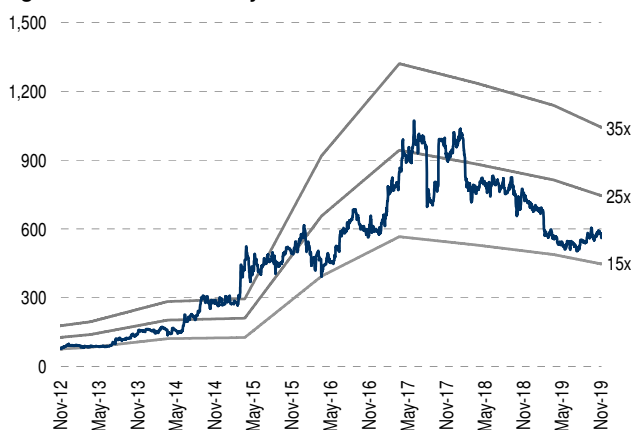
Fig 11 – Change in estimates

₹ m	Old estimates		New estimates		Change (%)	
	FY20e	FY21e	FY20e	FY21e	FY20e	FY21e
Revenue	22,776	21,825	21,250	19,419	(6.7)	(11.0)
EBITDA	8,723	8,075	7,416	6,525	(15.0)	(19.2)
PAT	6,950	6,329	5,923	5,117	(14.8)	(19.1)

Source: Anand Rathi Research

At the CMP of ₹561, the stock trades at 17.2x and 19.9x respective FY20e and FY21e earnings. We retain our Buy recommendation with a lower price target of ₹729 (earlier ₹763), based on a sum-of-parts method. We value the base business at ₹506, based on 18x FY21 earnings and value the Revlimid opportunity at ₹223.

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	523	796	12.3	10.3	7.9	9.8	8.0	6.7	5.5	20.1	21.4	12.6	14.3
Ajanta	Hold	991	1,072	86.9	20.4	16.6	22.0	18.6	13.3	11.1	17.6	18.8	17.6	18.7
Alembic	Hold	576	624	108.6	15.4	16.6	17.4	16.3	10.8	10.9	23.6	18.6	17.9	14.9
Alkem	Buy	2066	2282	247.0	23.5	19.0	24.5	19.9	17.9	14.3	18.1	19.6	18.2	19.9
Cadila	Hold	230	266	235.5	15.7	14.7	16.0	14.1	10.2	9.4	13.8	13.4	9.0	9.0
Dishman	Buy	124	362	20.0	6.4	5.5	11.1	8.6	4.4	3.7	15.4	16.3	11.2	12.1
Eris	Buy	418	614	57.4	16.2	13.6	17.0	15.0	13.0	10.3	26.7	24.6	27.0	27.2
Granules India	Buy	120	172	30.5	9.6	8.4	9.0	7.6	7.0	5.5	18.9	18.3	12.0	13.6
Indoco Remedies	Buy	153	191	14.1	46.2	14.4	29.4	10.9	13.5	7.8	4.5	13.5	5.0	11.6
Ipca Labs.	Hold	1,069	1,172	135.1	22.8	18.2	20.8	16.6	15.1	12.1	17.5	18.6	15.2	16.4
JB Chemicals	Buy	398	551	31.9	11.1	10.1	12.3	10.7	7.2	6.2	18.1	18.3	17.4	17.6
Natco Pharma	Buy	561	729	105.6	17.8	20.6	16.7	16.5	13.9	15.4	15.9	12.2	14.7	11.5
Neuland	Buy	504	667	6.5	15.5	11.3	15.1	10.4	8.7	6.8	5.9	7.5	5.7	6.9
Pfizer	Hold	3994	3265	182.7	39.7	34.3	31.2	27.2	25.1	21.6	14.5	15.2	14.5	15.2
Suven Life Sciences	Buy	286	300	36.4	29.5	28.1	27.3	23.2	17.6	16.1	14.1	13.3	13.0	12.4
Torrent Pharma	Hold	1,819	1,768	307.9	32.7	24.9	32.3	24.7	15.7	13.4	18.9	22.0	13.2	17.0
HCG	Buy	116	175	10.2	NM	NM	NM	NM	12.0	9.7	NM	NM	3.1	3.6

Source: Company, Anand Rathi Research

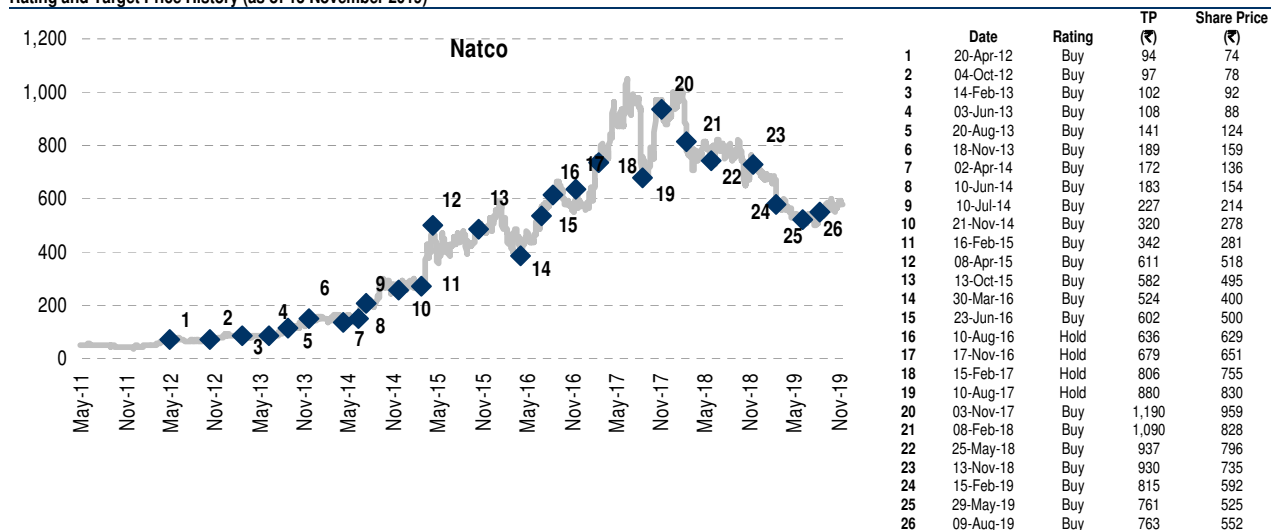
Appendix

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