

Natco Pharma

10 August 2018

Reuters: NATP.NS; Bloomberg: NTCPH IN

Challenged By A High Base

Natco Pharma (NPL) reported consolidated revenues of Rs5,386mn for 1QFY19 which were 9%/18% below our/consensus estimate, respectively. Net earnings at Rs1,810mn were 7% and 21% below our/consensus estimate, respectively. The miss was largely because of a lower profit share during the quarter. The company has given guidance that a portion of the profit share has been deferred owing to uncertainty on chargeback, but it will be booking the same in subsequent quarters. EBITDA margin for the quarter at 44.1% was 700bps lower compared to 4QFY18. The previous quarter benefited from limited competition launch of Tamiflu suspension.

Copaxone generic market share remained flat during the quarter as conversion from the brand name is slower, but the average market share (QoQ) was higher. We believe that lower conversion in Copaxone generic can be primarily attributed to the aggressive pricing strategy adopted by the innovator (Teva). Effective realisation per prescription for Teva is almost down 43% on YoY basis, which implies that it is as competitive as a generic player on the pricing front. We do not expect competitors to play the pricing card any further and rather contend with a fair share of the pie. Unlike typical generics, in case of Copaxone, the generic players have chosen to promote their substitutes/copies under a brand which signifies that there is a floor to the pricing and in addition the intention/way to gain market share is promotion rather than price cut.

NPL continues to fortify its ex-US business as domestic revenues witnessed a sharp increase led by oncology and new launches in India. In addition during the quarter, the company also received approval in Brazil for two generics, one of which is the first-to-market generic version. The new approvals should allow NPL to achieve break-even in Brazil which is burning about Rs250mn annually. The break-even should happen from 3Q onwards.

Outlook and valuation: Earnings run-rate should strengthen as we move into the year. The key catalysts that will drive earnings growth are:

- 1) Market share ramp-up in Copaxone generic - Based on Teva guidance, the company anticipates a 35% decline in Copaxone generic sales in 2HCY18 as compared to 1HCY18 because of generic competition.
- 2) Approval for Bosentan and Gilevec generics likely in the US (around 3QFY19).
- 3) Contribution from Tamiflu generic suspension likely in 3QFY19 and 4QFY19. The contribution will be significantly lower compared to FY18 (about 70%-80%), but incremental when compared to 1QFY19.
- 4) Ramp-up in Brazil and Canada.
- 5) Domestic market growth should sustain as 8-10 new molecule launches are planned per year and the HCV portfolio - which was so far declining - has stabilised.

We have retained our Buy rating on NPL with a target price of Rs915, which represents 17% upside from the CMP. Our target price is based on 20x FY20E EPS.

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BUY

Sector: Pharmaceuticals

CMP: Rs781

Target Price: Rs915

Upside: 17%

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Key Data

Current Shares O/S (mn)	184.5
Mkt Cap (Rsbn/US\$bn)	144.1/2.1
52 Wk H / L (Rs)	1,062/671
Daily Vol. (3M NSE Avg.)	243,526

Price Performance (%)

	1 M	6 M	1 Yr
Natco Pharma	(2.8)	(4.0)	(5.8)
Nifty Index	5.7	9.7	15.8

Source: Bloomberg

Y/E March (Rsmn)	1QFY18	4QFY18	1QFY19	YoY (%)	QoQ (%)
Revenues	4,453	7,678	5,386	21.0	(29.9)
Raw material costs	1,266	1,230	873	(31.0)	(29.0)
%age of revenues	28.4	16.0	16.2	(1,222bps)	19bps
Staff costs	631	1,101	887	40.6	(19.4)
%age of revenues	14.2	14.3	16.5	230bps	213bps
Other expenses	1,189	1,514	1,450	22.0	(4.2)
%age of revenues	26.7	19.7	26.9	22bps	720bps
EBITDA	1,367	3,833	2,176	59.2	(43.2)
EBITDA margin	30.7	49.9	40.4	970bps	(952bps)
Other income	34	201	359	-	78.6
Interest costs	39	30	28	(28.2)	(6.7)
Depreciation	150	180	184	22.7	2.2
PBT	1,212	3,824	2,323	91.7	(39.3)
Tax	275	827	512	86.2	(38.1)
Tax rate (%)	22.7	21.6	22.0	(65bps)	41bps
PAT	937	2,997	1,811	93.3	(39.6)

Source: Company, Nirmal Bang Institutional Equities Research

Earnings conference-call takeaways

Other income: The company booked other income of Rs359mn during the quarter of which Rs140mn came from foreign exchange gains and Rs200mn was booked as interest income from cash deposits.

Profit share: It will continue to be good over the coming quarters as some of the past profit has been deferred because the company was awaiting clarity on chargeback.

Copaxone generic: Expect to improve over time and we should see the impact in the next financial year. (13:28). Copaxone generic remains an at-risk launch as of now and NPL's liabilities are limited based on an agreement with Mylan

Revlimid generic: The approval may come by the end of this financial year.

Nexavar generic: The litigation has been settled and a launch date has been scheduled. Mylan is the partner for the product.

Bosentan generix: TAD is likely in the next two months.

Glivec generic: TAD is expected in the next two months.

Domestic business: It should grow by around 15%-20% every year

ANDA filings: Expect seven to eight filings every year and most of these are likely to be complex.

Capex: Planned Rs4bn capex. Rs1bn was spent during the quarter.

Tamiflu suspension contribution: Expect Tamiflu suspension to erode about 70%-80% in FY19E compared to FY18.

Cash position: Cash balance stands at Rs14,340mn.

Emerging markets: Two approvals in Brazil, one of which is a first-time generic and expect to achieve break-even in the December 2018 quarter. The company was incurring a cash loss of Rs250mn. Expect additional approvals as well. Quarterly run-rate in Brazil is Rs 80mn- Rs100mn. Cash loss will be arrested.

R&D spending: It was about 7.5 % and is expected to be in the range of 6%-8%.

Canada: Generated US\$15mn last year and should touch US\$20mn-US\$25mn next year.

Ticagrelor: The launch has been blocked by litigation from the innovator. It is a Rs1,700mn brand. There are two other generic companies also under litigation which include Dr. Reddy's Laboratories and Micro Labs.

Current field force size: 300 – 350 people.

Exhibit 1: Actual performance versus our/Bloomberg consensus estimates

(Rsmn)	Actual	Our est.	Var. (%)	Bloomberg cons. est.	Var. (%)
Sales	5,386	5,900	(8.7)	6,588	(18.2)
EBITDA	2,176	2,485	(12.4)	3,042	(28.5)
EBITDA margin (%)	40.4	42.1	(172bps)	46.2	(577bps)
Reported PAT	1,811	1,956	(7.4)	2,288	(20.8)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Key financials

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY 20E
Net sales	10,801	20,202	21,848	23,711	23,010
EBITDA	2,656	6,834	9,284	12,173	10,539
Net profit	1,571	4,860	6,962	9,229	8,443
EPS (Rs)	9.1	27.9	38.8	50.0	45.76
EPS growth (%)	11.9	206.4	39.2	28.9	(8.5)
EBITDA margin (%)	24.6	33.8	42.5	51.3	45.8
P/E (x)	85.8	28.0	20.1	15.6	17.1
P/BV (x)	10.8	8.3	4.4	3.5	3.0
EV/EBITDA (x)	53.0	20.2	14.7	10.8	12.2
RoCE (%)	22.0	42.6	31.4	30.8	23.3
RoE (%)	12.1	29.5	22.7	23.3	17.6

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Quarterly revenue snapshot

Revenue (Rsmn)	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19
Domestic formulations	2,280	2,162	2,188	2,180	1,821	2,134	1,658	1,585	1,910
Oncology	730	771	883	840	730	973	848	828	929
Hep C	1,340	1,121	1,121	1,220	845	948	685	624	741
Other	210	270	184	120	246	213	125	133	242
Export formulations	510	1,389	3,581	2,890	1,338	1,268	2,890	4,920	2,140
Profit share	-	-	-	-	902	600	2,540	4,330	2,100
Export sales	-	-	-	-	436	668	350	590	263
Total formulations	2,790	3,551	5,769	5,070	3,159	3,402	4,548	6,505	4279
API	400	476	507	560	863	584	811	1,337	673
QoQ growth (%)									
Domestic formulations	2.2	(5.2)	1.2	(0.4)	(16.5)	17.2	(22.3)	(4.4)	20.5
Oncology	4.3	5.6	14.5	(4.9)	(13.1)	33.3	(12.8)	(2.4)	9.9
Hep C	25.2	(16.3)	-	8.8	(30.7)	12.2	(27.7)	(8.9)	20.2
Other	(54.3)	28.6	(31.9)	(34.8)	105.0	(13.4)	(41.3)	6.4	88.0
Export formulations	(51.4)	172.4	157.8	(19.3)	(53.7)	(5.2)	127.9	70.2	(56.5)
Total formulations	(14.9)	27.3	62.5	(12.1)	(37.7)	7.7	33.7	43.0	(37.7)
API	2.6	19.0	6.5	10.5	54.1	(32.3)	38.9	64.9	(49.9)

Source: Company, Nirmal Bang Institutional Equities Research

Financial statements

Exhibit 4: Income statement

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
Net sales	10,801	20,202	21,848	23,711	23,010
% growth	30.9	87.0	8.1	8.5	(3.0)
Raw material costs	2,706	5,991	4,111	3,881	3,991
Staff costs	1,798	2,432	3,256	3,663	4,212
Other expenditure	3,641	4,945	5,197	3,994	4,268
Total expenditure	8,145	13,368	12,564	11,538	12,471
EBITDA	2,656	6,834	9,284	12,173	10,539
% growth	24.5	157.3	35.9	31.1	(13.4)
EBITDA margin (%)	24.6	33.8	42.5	51.3	45.8
Other income	96	139	404	630	1,383
Interest costs	229	185	154	176	174
Gross profit	8,095	14,211	17,737	19,830	19,019
% growth	38.9	75.6	24.8	11.8	(4.1)
Depreciation	508	544	662	861	986
Profit before tax	2,037	6,244	8,872	11,766	10,762
% growth	51.8	206.5	42.1	32.6	(8.5)
Tax	479	1,395	1,920	2,546	2,329
Effective tax rate (%)	23.5	22.3	21.6	21.6	21.6
Net profit	1,571	4,860	6,962	9,229	8,443
% growth	16.7	209.3	43.3	32.6	(8.5)
EPS (Rs)	9.1	27.9	38.8	50.0	45.8
% growth	11.9	206.4	39.2	28.9	(8.5)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
Equity	348	349	369	369	369
Reserves	12,609	16,144	30,353	39,320	47,501
Net worth	12,957	16,493	30,722	39,689	47,870
Net deferred tax liabilities	147	150	139	139	139
Total debt	984	2,216	1,732	2,108	2,080
Other non-current liabilities	182	268	370	370	370
Liabilities	14,270	19,127	32,963	42,306	50,459
Net block	7,046	8,272	10,127	12,423	13,937
Capital WIP	2,118	3,363	4,800	4,800	4,800
Intangible assets and goodwill	55	58	59	59	59
Other non-current assets	628	610	858	858	858
Inventories	3,573	3,489	4,384	2,260	2,324
Debtors	2,616	4,752	6,375	5,577	5,413
Cash	452	358	1,837	11,088	17,829
Other current assets	1,729	2,274	8,711	8,727	8,726
Total current assets	8,370	10,873	21,307	27,653	34,292
Creditors	2,756	2,627	2,691	1,702	1,750
Other current liabilities	1,191	1,422	1,497	1,785	1,736
Total current liabilities	3,947	4,049	4,188	3,487	3,486
Net current assets	4,423	6,824	17,119	24,166	30,806
Total assets	14,270	19,127	32,963	42,306	50,459

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Cash flow

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
EBIT	2,266	6,429	9,026	11,942	10,935
(Inc.)/dec. in working capital	(1,727)	(2,495)	(8,816)	2,204	102
Cash flow from operations	539	3,934	210	14,145	11,037
Other income	(96)	(139)	(404)	(630)	(1,383)
Depreciation	508	544	662	861	986
Other non-cash expenses	6	3	(11)	-	-
Tax paid	(479)	(1,395)	(1,920)	(2,546)	(2,329)
Net cash from operations	478	2,947	(1,463)	11,830	8,312
Capital expenditure	(1,338)	(3,018)	(3,955)	(3,157)	(2,500)
Net cash after capex	(859)	(71)	(5,418)	8,673	5,812
Other investment activities	90	157	156	630	1,383
Cash from financial activities	1,089	(180)	6,741	(52)	(453)
Opening cash balance	134	452	358	1,837	11,088
Closing cash balance	452	358	1,837	11,088	17,829
Change in cash balance	319	(94)	1,479	9,251	6,742

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Key ratios

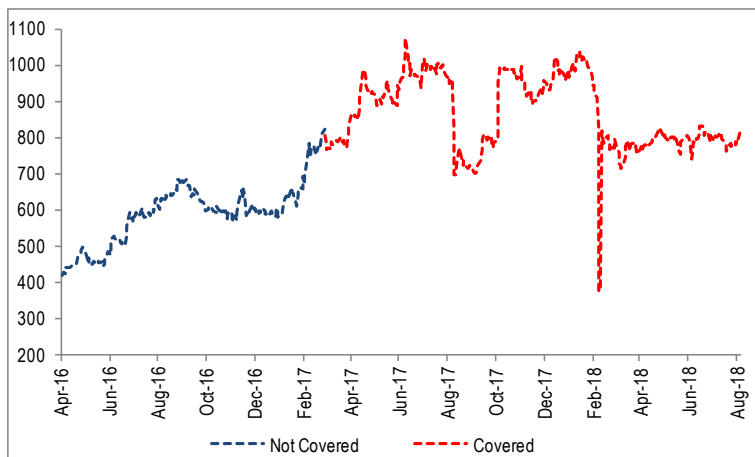
Y/E March	FY16	FY17	FY18	FY19E	FY20E
Profitability & return ratios					
EBITDA margin (%)	24.6	33.8	42.5	51.3	45.8
EBIT margin (%)	21.0	31.8	41.3	50.4	47.5
Net profit margin (%)	14.5	24.1	31.9	38.9	36.7
RoE (%)	12.1	29.5	22.7	23.3	17.6
RoCE (%)	22.0	42.6	31.4	30.8	23.3
Working capital & liquidity ratios					
Receivables (days)	88.4	85.9	106.5	85.9	85.9
Inventory (days)	481.9	212.6	389.2	212.6	212.6
Payables (days)	371.7	160.0	238.9	160.0	160.0
Current ratio (x)	2.1	2.7	5.1	7.9	9.8
Quick ratio (x)	1.2	1.8	4.0	7.3	9.2
Valuation ratios					
EV/sales (x)	13.0	6.8	6.2	5.5	5.6
EV/EBITDA (x)	53.0	20.2	14.7	10.8	12.2
P/E (x)	85.8	28.0	20.1	15.6	17.1
P/BV (x)	10.8	8.3	4.4	3.5	3.0

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
28 February 2017	Sell	823	725
1 June 2017	Accumulate	933	940
8 August 2017	Accumulate	924	940
6 October 2017	Buy	953	1,102
7 February 2018	Buy	829	955
25 May 2018	Buy	790	915
10 August 2018	Buy	781	915

Rating track graph



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