

Natco Pharma

12 February 2015

Reuters: NATP.BO; Bloomberg: NTCPH IN

Weak Performance

Natco Pharma's (NPL) 3QFY15 performance was below expectations with reported revenue of Rs1.9bn down 4%/11% YoY/QoQ, respectively, and 15% below our estimate/Bloomberg consensus estimate each, mainly on account of nil revenue from a Venezuelan contract. EBITDA of Rs476mn was 24% below our estimate/Bloomberg consensus estimate each and reported PAT of Rs143mn was 61%/60% below our/Bloomberg consensus estimates, respectively, on account of a one-time settlement payment of Rs151mn made to SMS Pharma. We are more excited about NPL's strong US drug pipeline and do not see any risk to its earnings over the next four-five years, as many on the street believe. We continue to remain sanguine on NPL's research and development-driven US drug pipe line and believe it has enough levers to keep the growth momentum intact over the medium term, even beyond Copaxone.

3QFY15 performance below expectations: NPL's 3QFY15 reported revenue of Rs1.9bn (down 4%/11% YoY/QoQ), was 15% below our estimate/Bloomberg consensus estimate each on account of nil revenue for the quarter from the Venezuelan contract as a result of which export formulations revenue declined 44%/53% YoY/QoQ, respectively, to Rs290mn compared to Rs530mn in 2QFY15 (being the first quarter which witnessed revenue from the Venezuelan contract). The fall in revenue was cushioned by the domestic oncology segment, up 27%/18% YoY/QoQ, respectively, on account of better traction in Azacitidine and Trabectedin which was launched in 2QFY15 and the growth in domestic oncology segment being volume-driven. Other geographies in the formulations segment remained flat. EBITDA at Rs476mn, down 12%/19% YoY/QoQ, respectively, was 24% below our estimate/Bloomberg consensus estimate each. Operating margin of 24.3% was below our/Bloomberg consensus estimates of 27.0%/27.1% by 270bps/280bps, respectively, on account of: a) Gross margin declining 380bps/290bps YoY/QoQ, respectively, which can be attributed to the fact that there is no revenue from higher gross margin Venezuelan contract (in 2QFY15, it led to improvement in gross margin as highlighted by the management), b) Higher staff costs at 17% as a percentage of sales (15.4% in 2QFY15 and 14.6% in 3QFY14). However, other expenses declined 17% YoY/QoQ each on account of no commission paid in respect of Venezuelan contract. Depreciation was up 58%YoY because of the change in valuation of useful life of the assets as per the new Companies Act. PAT stood at Rs143mn, (down 52%/56% YoY/QoQ) and 61%/60% below our/Bloomberg consensus estimates, respectively. However, adjusting for an exceptional item of Rs151mn, which pertains to an one-time settlement payment made to SMS Pharma, adjusted PAT of Rs295mn was down 1%/9% YoY/QoQ and 19%/18% below our/Bloomberg consensus estimates, respectively. The fall in PAT was cushioned by higher other income.

Drug pipeline strong, even beyond Copaxone: Interestingly, NPL had filed its pre-grant opposition with India's patent office to block Gilead's pending patent application for Sovaldi, which, if granted, can be a huge driver of NPL's domestic business. NPL expects to launch the product in 1QFY16. Over the next two years, in addition to Copaxone, we expect NPL to launch : a) Sovaldi in domestic market (largest-selling Hepatitis C product in the world; India has a population of 12mn Hepatitis C patients) b) Treanda (market size:US\$660mn) c) Generic Vidaza (market size: US\$270mn, filed six months ago), d) Generic Entocort capsules (market size:US\$300mn, Mylan and Teva are the only players currently in the market), one product to be sold under the REMS(Risk Evaluation & Mitigation Strategy) programme in November 2015, and generic Fosrenol (market size:US\$115mn; shared marketing exclusivity; launch in CY15). Post FY17, the drug pipeline is detailed in Exhibit 1.

UNDER REVIEW

SECTOR: Pharmaceuticals

CMP: Rs1,340

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Key Data

Current Shares O/S (mn)	33.2
Mkt Cap (Rsbn/US\$m)	46.6/748.6
52 Wk H / L (Rs)	1,590/650
Daily Vol. (3M NSE Avg.)	49,575

Price Performance (%)

	1 M	6 M	1 Yr
Natco Pharma	(1.5)	35.5	82.7
Nifty Index	4.7	12.7	43.2

Source: Bloomberg

Y/E March (Rsmn)	3QFY14	2QFY15	3QFY15	YoY (%)	QoQ (%)	9MFY14	9MFY15	YoY (%)
Net revenue	2,034	2,192	1,955	(3.9)	(10.8)	5,551	6,247	12.5
Raw material (RM) costs	579	644	631	8.9	(2.1)	1,705	1,931	13.3
RM costs/net revenue (%)	28.5	29.4	32.3	-	-	30.7	30.9	-
Personnel costs	298	337	333	11.9	(1.2)	820	988	20.5
Personnel costs/net revenue (%)	14.6	15.4	17.0	-	-	14.8	15.8	-
Other expenses	618	623	516	(16.5)	(17.2)	1,606	1,692	5.4
Other expenses/ net revenue (%)	30.4	28.4	26.4	-	-	28.9	27.1	-
EBITDA	539	588	476	(11.8)	(19.2)	1,421	1,636	15.1
EBITDA margin (%)	26.5	26.8	24.3	-	-	25.6	26.2	-
Other income	13	32	73	478.0	130.1	68	121	78.5
Interest costs	92	72	85	(7.7)	17.5	292	223	(23.6)
Depreciation	77	112	122	58.2	9.2	225	345	53.3
Exceptional	-	-	151	-	-	-	151	-
PBT	383	436	191	(50.1)	(56.3)	972	1,037	6.7
Tax	108	124	54	(49.9)	(56.3)	247	266	7.9
Tax/PBT (%)	28.3	28.4	28.4	-	-	25.4	25.7	-
Share of minority partner	(24)	(11)	(7)	(72.0)	(39.8)	(61)	(31)	(49.8)
Reported PAT	299	324	143	(52.0)	(55.7)	786	802	2.0
Adjusted PAT	299	324	295	(1.4)	(8.9)	786	953	21.3

Source: Company, Nirmal Bang Institutional Equities Research

Please refer to the disclaimer towards the end of the document.

Exhibit 1: Product pipeline

Generic name	Brand name	Indication	Market size (US\$mn)	Status	ANDA ownership	Partner	Likely launch	Comments
Lanthanum Carbonate	Fosrenol	Renal disease	115	NA	NPL	Lupin	CY15	Alkem, Mylan and Teva are the other filers.
Oseltamivir	Tamiflu	Influenza infection	500	Sole first to file or FTF	NPL	Alvogen	FY17/FY18	NPL has filed only for one patent (#483), which expires in June 2017. If NPL proves non-infringement, then the earliest launch can be in September 2016.
Armodafinil	Nuvigil	Excessive sleepiness	400	Shared FTF	NPL	Breckenridge	FY17	As per the settlement with Cephalon, Actavis will launch 100mg and 200mg dosages in June 2016, while others will launch after that. Mylan will launch 50mg, 150mg and 250mg dosages in June 2016, while others will launch after that. Should be a five-six player market.
Lapatinib	Tykerb	Anti-cancer	125	Sole FTF	NPL	Lupin	FY18	NPL has not been sued for the product. It is the only filer so far.
Bendamustine Hydrochloride	Treanda	Oncology	660	Shared FTF	NPL	Breckenridge	FY18	Likely to be a competitive opportunity.
Glatiramer Acetate	Copaxone (40mg)	Multiple sclerosis	2,100	Shared FTF	Mylan	Mylan	FY18	Likely to be shared marketing exclusivity along with Dr Reddy's Laboratories and Sandoz.
Lenalidomide	Revlimid	Multiple myeloma	3,000	Sole FTF	NPL	Actavis	Unknown	Markman hearing began in May 2014.
Everolimus	Zortress	Kidney transplant drug	43	Sole FTF	Breckenridge	Breckenridge	Unknown	Unlikely to be a material opportunity because of its small market size.
Fingolimod	Gilenya	Multiple sclerosis	1,200	Shared FTF	Unknown	Unknown	Unknown	Likely to be a competitive opportunity.
Cabazitaxel	Jevtana	Oncology	116	Shared FTF	Unknown	Unknown	Unknown	Likely to be a competitive opportunity.
Sorafenib	Nexavar	Oncology	48	FTF	Unknown	Mylan	Unknown	Likely to be a competitive opportunity.

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Financial summary

Y/E March (Rsmn)	FY13	FY14	FY15E	FY16E	FY17E
Revenue	6,484	7,389	8,909	10,426	12,067
YoY (%)	24.7	14.0	20.6	17.0	15.7
EBITDA	1,379	1,794	2,138	2,554	3,017
EBITDA (%)	21.3	24.3	24.0	24.5	25.0
Reported PAT	719	1,027	1,311	1,621	2,011
YoY (%)	20.5	42.9	27.7	23.6	24.1
Adjusted PAT	835	1,027	1,311	1,621	2,011
YoY (%)	40.0	23.1	27.7	23.6	24.1
Reported EPS	22.9	31.1	39.4	48.7	60.4
Adjusted EPS	26.6	31.1	39.4	48.7	60.4
RoE (%)	14.3	16.3	16.8	18.0	19.1
RoCE (%)	13.7	15.3	16.5	17.9	19.4
P/E (x)	50.4	43.1	34.0	27.5	22.2
EV/EBITDA (x)	31.9	25.2	21.8	18.4	15.5

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Revenue break-up

(Rsmn)	3QFY14	2QFY15	3QFY15	YoY (%)	QoQ (%)
API	506	680	596	17.8	(12.4)
Domestic	105	280	76	(27.4)	(72.9)
Exports	401	400	520	29.5	30.0
Formulations	1,340	1,440	1,200	(10.5)	(16.7)
Oncology - Domestic	416	450	530	27.3	17.8
Others-Domestic+Brazil	160	90	90	(43.8)	-
Exports	514	620	290	(43.5)	(53.2)
US retail	250	280	290	16.0	3.6
Total	1,846	2,120	1,796	(2.7)	(15.3)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Actual performance versus our estimates

(Rsmn)	Actual	NBIE estimates	Variation (%)	Bloomberg Estimates	Variation (%)
Revenue	1,955	2,300	(15.0)	2,295	(14.8)
EBITDA	476	622	(23.5)	622	(23.5)
EBITDA margin (%)	24.3	27.0	(270)bps	27.1	(280)bps
Reported PAT	143	364	(60.6)	360	(60.2)
Adjusted PAT	295	364	(19.0)	360	(18.2)

Source: Company, Nirmal Bang Institutional Equities Research

Financial statement

Exhibit 5: Income statement

Y/E March (Rsmn)	FY13	FY14	FY15E	FY16E	FY17E
Net sales (incl other operat. income)	6,484	7,389	8,909	10,426	12,067
% growth	24.7	14.0	20.6	17.0	15.7
Raw material costs	(2,428)	(2,332)	(2,940)	(3,389)	(3,862)
Staff costs	(1,023)	(1,128)	(1,336)	(1,564)	(1,810)
Other costs	(1,508)	(1,992)	(2,495)	(2,919)	(3,379)
Total expenditure	(5,105)	(5,595)	(6,771)	(7,872)	(9,051)
EBITDA	1,379	1,794	2,138	2,554	3,017
% growth	29.7	30.1	19.2	19.5	18.1
EBITDA margin (%)	21.3	24.3	24.0	24.5	25.0
Other income	245	167	100	125	150
Interest costs	(263)	(366)	(291)	(284)	(240)
Gross profit	1,361	1,595	1,948	2,396	2,927
% growth	41.5	17.2	22.1	23.0	22.2
Depreciation	(221)	(304)	(351)	(382)	(413)
Profit before tax	1,140	1,290	1,597	2,014	2,514
% growth	42.0	13.2	23.8	26.1	24.8
Exceptional items	(116)	-	-	-	-
Tax	(364)	(309)	(335)	(443)	(553)
Effective tax rate (%)	32.0	23.9	21.0	22.0	22.0
Minority interest	59.9	46.3	50.0	50.0	50.0
Prior-period items	(0.8)	(0.5)	-	-	-
Net profit	719	1,027	1,311	1,621	2,011
% growth	20.5	42.9	27.7	23.6	24.1
Adj profit	835	1,027	1,311	1,621	2,011
% growth	40.0	23.1	27.7	23.6	24.1

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY13	FY14	FY15E	FY16E	FY17E
Equity	314	331	331	331	331
Reserves	5,022	6,928	8,007	9,319	11,021
Net worth	5,336	7,259	8,338	9,650	11,352
Short-term loans	1,477	986	1,286	1,286	1,286
Long-term loans	1,900	1,418	1,355	1,292	892
Total loans	3,377	2,404	2,641	2,578	2,178
Deferred tax liability	443	431	431	431	431
Minority Interest	105	69	69	69	69
Othr long-term liabilities	7	10	10	10	10
Liabilities	9,268	10,173	11,489	12,737	14,040
Gross block	7,256	8,199	8,999	9,799	10,599
Depreciation	1,429	1,751	2,102	2,485	2,898
Net block	5,827	6,447	6,896	7,314	7,701
Capital work-in-progress	1,058	1,238	1,088	938	788
Long-term Investments	24	19	19	19	19
Inventories	1,460	1,811	1,941	2,280	2,653
Debtors	1,297	1,188	1,730	2,033	2,365
Cash balance	127	110	113	458	817
Other current assets	1,010	1,111	1,379	1,620	1,885
Total current assets	3,894	4,221	5,163	6,391	7,721
Creditors	1,143	1,098	1,516	1,762	2,026
Other current liabilities	393	686	193	193	193
Total current liabilities	1,536	1,784	1,709	1,956	2,220
Net current assets	2,357	2,437	3,454	4,435	5,501
Non current assets	1	32	32	32	32
Total assets	9,268	10,173	11,489	12,737	14,040

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Cash flow

Y/E March (Rsmn)	FY13	FY14	FY15E	FY16E	FY17E
EBIT	1,158	1,489	1,787	2,172	2,603
(Inc.)/dec. in working capital	(415)	(109)	(1,014)	(636)	(706)
Cash flow from operations	743	1,381	773	1,537	1,897
Other income	245	167	100	125	150
Depreciation	221	304	351	382	413
Interest paid (-)	(263)	(366)	(291)	(284)	(240)
Tax paid (-)	(364)	(309)	(335)	(443)	(553)
Dividends paid (-)	(146)	(193)	(232)	(309)	(309)
Minority Interest (-)	60	46	50	50	50
Net cash from operations	496	1,030	416	1,058	1,409
Capital expenditure (-)	(2,292)	(1,122)	(650)	(650)	(650)
Net cash after capex	(1,796)	(92)	(234)	408	759
Inc./(dec.) in short-term borrowing	661	(491)	300	-	-
Inc./(dec.) in long-term borrowing	130	(482)	(63)	(63)	(400)
Inc./(dec.) in borrowings	791	(973)	237	(63)	(400)
(Inc.)/dec. in investments	602	5	-	-	-
Equity issue/(buyback)	59	1,085	-	-	-
Cash from financial activities	1,452	117	237	(63)	(400)
Others	104	(41)	-	-	-
Opening cash balance	366	127	110	113	458
Closing cash balance	127	110	113	458	817
Change in cash balance	(240)	(16)	3	345	359

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Key ratios

Y/E March	FY13	FY14	FY15E	FY16E	FY17E
Per share (Rs)					
Reported EPS	22.9	31.1	39.4	48.7	60.4
Adjusted EPS	26.6	31.1	39.4	48.7	60.4
DPS	4.0	5.0	6.0	8.0	8.0
BV/share	170.1	219.5	252.1	291.8	343.2
Dividend payout (%)	20.3	18.8	17.7	19.1	15.4
Performance ratios (%)					
RoE	14.3	16.3	16.8	18.0	19.1
RoCE	13.7	15.3	16.5	17.9	19.4
Valuation ratios (x)					
P/E	50.4	43.1	34.0	27.5	22.2
P/BV	7.9	6.1	5.3	4.6	3.9
EV/net sales	7.0	6.3	5.3	4.5	3.8
EV/EBITDA	31.9	25.2	21.8	18.4	15.5
Efficiency ratios					
Asset turnover (x)	0.8	0.8	0.9	1.0	1.1
Working capital/sales (x)	0.35	0.32	0.38	0.39	0.39
Receivable days	76	74	74	74	74
Inventory days	85	83	83	83	83
Payable days	82	82	82	82	82

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
10 September 2013	Buy	587	716
7 October 2013	Buy	621	716
18 November 2013	Buy	799	923
7 January 2014	Buy	798	923
14 February 2014	Buy	744	1,064
28 March 2014	Buy	788	1,064
2 April 2014	Buy	685	940
23 April 2014	Buy	772	1,030
3 June 2014	Buy	753	1,030
10 July 2014	Accumulate	1,072	1,030
14 August 2014	Accumulate	1,084	1,125
13 November 2014	Buy	1,405	1,674
6 January 2015	Buy	1,428	1,674

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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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