

Natco Pharma

28 May 2019

Reuters: NATP.NS; Bloomberg: NTCPH IN

Earnings Hit By Steep Price Erosion And Inventory Write-off

Natco Pharma's (NPL) revenues in 4QFY19 at Rs4,557mn were 24.7% below our estimate and 20.8% below consensus estimate. The revenues declined 18.1% QoQ and 40.6% YoY. The revenues in FY19 at Rs20,495mn showed a decline of 5%. The decline in the revenues was primarily because of pricing pressure in Copaxone generic as Teva continues to drop prices to retain majority share of the pie.

EBITDA for the quarter at Rs1,483mn showed a decline of 28.8% QoQ and 61.3% YoY. EBITDA margin witnessed a decline of 1738bps YoY. EBITDA was unfavourably impacted by a US\$5.5mn write-off in Tamiflu generic.

Net earnings at Rs1,204mn declined 24.4% QoQ and 59.8% YoY and were below our estimate/consensus estimate by 42.6%/28.8%, respectively. Net earnings - when adjusted for one-off inventory write-off - stood at Rs1,504mn, down 5.6%/49.8% QoQ/YoY, respectively.

We have retained Buy rating on the stock with a target price of Rs654 (from Rs779 earlier), up 25% from the CMP.

We have revised our estimates for NPL to account for the following:

- 1) Steep price erosion in Copaxone generic
- 2) Lower revenues from Bosentan generic in the US, which is now commoditised.

Outlook and valuation: Based on the revised forecasts, we have cut our target price on NPL to Rs654 (from Rs779 earlier) and retained Buy rating on the stock. NPL has given guidance of high single-digit growth in net earnings for FY20, which is expected to be largely driven by rest of world markets (Canada and Brazil) and India. These markets put together should post high-teen growth. As regards limited competition portfolio in the US, the company does not assume incremental competition in Copaxone generic, at least until the end of CY20. Early entry of Copaxone generic may pose downside risk to our earnings estimate. The company expects to ramp up sales in India and rest of the world markets with an objective to replace sales erosion in its limited competition portfolio in the US. NPL has also initiated efforts to monetise its portfolio in emerging markets like China where new regulations have lowered the entry barriers. Successful entry in China can be highly meaningful as new product launches can potentially be as lucrative as the US market. In Canada, the focus is to launch the oncology product portfolio. In addition, the company is also investing in the agrochemicals space and has identified a basket of niche difficult-to-make products (limited competition) that would give it a competitive advantage.

BUY

Sector: Pharmaceuticals

CMP: Rs525

Target Price: Rs654

Upside: 25%

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Key Data

Current Shares O/S (mn)	182.9
Mkt Cap (Rsbn/US\$bn)	97.5/1.4
52 Wk H / L (Rs)	849/480
Daily Vol. (3M NSE Avg.)	290,627

Price Performance (%)

	1 M	6 M	1 Yr
Natco Pharma	0.5	(25.4)	(33.3)
Nifty Index	1.5	11.2	11.6

Source: Bloomberg

Y/E March (Rsmn)	4QFY18	3QFY19	4QFY19	YoY (%)	QoQ (%)	FY18	FY19	YoY (%)
Revenues	7,678	5,567	4,557	(40.6)	(18.1)	22,020	20,945	(4.9)
Raw material expenses	1,230	1,050	670	(45.5)	(36.2)	4,283	3,542	(17.3)
%age of revenues	16.0	18.9	14.7	(132bps)	(416bps)	19.5	16.9	(254bps)
Staff costs	1,101	933	813	(26.2)	(12.9)	3,256	3,559	9.3
%age of revenues	14.3	16.8	17.8	350bps	108bps	14.8	17.0	221bps
Other expenses	1,514	1,500	1,591	5.1	6.1	5,197	5,896	13.5
%age of revenues	19.7	26.9	34.9	1,519bps	797bps	23.6	28.1	455bps
EBITDA	3,833	2,084	1,483	(61.3)	(28.8)	9,284	7,948	(14.4)
EBITDA margin	49.9	37.4	32.5	(1,738bps)	(489bps)	42.2	37.9	(421bps)
Other income	201	233	310	54.2	33.0	404	1,302	222.3
Interest	30	63	52	73.3	(17.5)	154	193	25.3
Depreciation	180	207	217	20.6	4.8	662	810	22.4
Exceptional item	-	-	-	-	-	-	-	-
PBT	3,824	2,047	1,524	(60.1)	(25.5)	8,872	8,247	(7.0)
Tax	827	454	320	(61.3)	(29.5)	1,920	1,823	(5.1)
Tax rate (%)	21.6	22.2	21.0	(63bps)	(118bps)	21.6	22.1	46bps
PAT	2,997	1,593	1,204	(59.8)	(24.4)	6,952	6,424	(7.6)
PAT Margin	39.0	28.6	26.4	(1,261bps)	(219) bps	31.6	30.7	(90bps)

Source: Company, Nirmal Bang Institutional Equities Research

Earnings conference-call takeaways

Export revenues: The revenue share of exports declined 35.3% on account of negligible income from Tamiflu generic in the US. PAT declined on a sequential basis because of falling contribution from Tamiflu generic and a decline in Copaxone generic price.

Tamiflu generic: Tamiflu generic sales have declined significantly this year and its contribution will become negligible from next year.

Revlimid generic approval: The company has responded to queries raised by the USFDA and its approval is expected any time.

Copaxone: NPL does not expect incremental generic competition, at least until the end of calendar year 2019.

Oncology business: The domestic oncology business has grown 22.7% sequentially to Rs1,141mn, translating into Rs 3,970mn annually. The company has given guidance regarding launch of 8-10 products during the year.

Brazil market: The company launched Everolimus and Letrozole in Brazil. It is planning to launch three to four products every year. The company will only look at high-value products and the potential opportunity size per product could be US\$4mn-US\$5mn.

Business strategy: As per its previous guidance, NPL maintains its focus on growing ROW market and is looking to add China as well. In the US, NPL is not bullish on commodity generics and is focusing only on niche and hard-to-do generics. India, Canada, Brazil and China seem to be the most lucrative markets, as per the company.

Revenue drivers: In the near term, market share gains from Copaxone generic should reflect in the earnings. In the medium term (FY20-FY21), the company expects growth to come from product launches in Brazil, China, Canada and India. In the long run, the company expects agrochemicals to start meaningfully contributing to revenues.

Capex: The company has given guidance of Rs3,500mn to Rs4,000mn going forward. It expects to spend another Rs500mn each on Vizag and Nellore facilities.

Agrochemicals space foray: The company expects the facility to be ready by October 2019. As far as the commercial strategy of NPL goes, the company is looking for tie-up with a partner in the US and will go alone in India. So far the company has committed capex of Rs1,000mn for agrochemicals and has incurred capex of Rs500mn. The company has given guidance that it will be focusing on niche molecules and not commodity products. The company has given guidance that profit contribution will start from FY22 or FY23.

Exhibit 1: Actual performance versus our/Bloomberg consensus estimates

(Rsmn)	Actual	NBIE estimate	Var. (%)	Consensus estimate	Var. (%)
Sales	4,557	6,051	(24.7)	5,754	(20.8)
EBITDA	1,483	2,763	(46.3)	2,289	(35.2)
EBITDA margin (%)	32.5	45.7	(1,312bps)	39.8	(723bps)
Reported PAT	1,204	2,098	(42.6)	1,692	(28.8)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Key financials

Y/E March (Rsmn)	FY17	FY18	FY19	FY20E	FY21E
Net sales	20,202	22,020	20,945	21,916	21,403
EBITDA	6,834	9,284	7,948	8,435	7,224
Net profit	4,860	6,962	6,444	6,882	6,034
EPS (Rs)	27.9	38.8	34.9	37.3	32.7
EPS growth (%)	206.4	39.2	(10.0)	6.8	(12.3)
EBITDA margin (%)	33.8	42.2	37.9	38.5	33.8
P/E (x)	31.0	20.0	15.0	14.1	16.1
P/BV (x)	9.1	4.4	2.7	2.3	2.0
EV/EBITDA (x)	22.3	14.6	12.0	10.7	11.8
RoCE (%)	42.6	31.4	23.3	21.8	16.8
RoE (%)	29.5	22.7	18.5	16.6	12.8

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Change in our estimates

(Rsmn)	New estimates		Old estimates		Change (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Net sales	21,916	21,403	22,913	23,677	(4.4)	(9.6)
EBITDA	8,435	7,224	9,159	9,059	(7.9)	(20.3)
Margin (%)	38.5	33.8	40.0	38.3	(148bps)	(451bps)
PAT	6,882	6,034	6,515	6,636	5.6	(9.1)
Margin (%)	31.4	28.2	28.4	28.0	297bps	17bps
EPS	37.3	32.7	35.3	36.0	5.6	(9.1)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Quarterly revenue break-up

Revenues (Rsmn)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
Domestic formulations	2,188	2,180	1,821	2,134	1,658	1,585	1,910	1,939	1,640	1,859
<i>Oncology</i>	883	840	730	973	848	828	929	970	930	1,141
<i>Hepatitis C</i>	1,121	1,220	845	948	685	624	741	790	500	429
<i>Other</i>	184	120	246	213	125	133	242	179	210	289
Export formulations	3,581	2,890	1,338	1,268	2,890	4,920	2,140	2,478	2,570	1,662
Total formulations	5,769	5,070	3,159	3,402	4,548	6,505	4,052	4,417	4,210	3,521
API	507	560	863	584	811	1,337	670	668	990	702
Revenue mix (%)										
Domestic formulations	34.9	38.7	45.3	53.5	30.9	20.2	40.5	35.7	29.5	40.7
<i>Oncology</i>	14.1	14.9	18.1	24.4	15.8	10.6	19.7	17.8	16.7	25.0
<i>Hepatitis C</i>	17.9	21.7	21.1	23.8	12.8	8.0	15.7	14.5	9.0	9.4
<i>Other</i>	2.9	2.1	6.1	5.3	2.3	1.7	5.1	3.3	3.8	6.3
Export formulations	57.1	51.4	33.2	31.8	54.0	62.7	45.3	45.6	46.2	36.4
Total formulations	91.9	90.1	78.6	85.3	84.9	83.0	85.8	81.3	75.6	77.2
API	8.1	9.9	21.4	14.7	15.1	17.0	14.2	12.3	17.8	15.4
QoQ growth (%)										
Domestic formulations	1.2	(0.4)	(16.3)	16.9	(22.3)	(4.4)	20.6	1.4	(15.4)	13.4
<i>Oncology</i>	14.5	(4.9)	(13.1)	33.3	(12.8)	(2.4)	12.2	4.4	(4.1)	22.7
<i>Hepatitis C</i>	-	8.8	(30.4)	11.7	(27.7)	(8.9)	18.8	6.6	(36.7)	(14.2)
<i>Other</i>	(31.9)	(34.8)	105.0	(13.4)	(41.3)	6.4	82.0	(26.0)	17.3	37.6
Export formulations	157.8	(19.3)	(53.7)	(5.2)	128.7	69.7	(56.5)	15.8	3.7	(35.3)
Total formulations	62.5	(12.1)	(37.6)	7.6	34.0	42.7	(37.7)	9.0	(4.7)	(16.4)
API	6.5	9.9	54.9	(32.3)	38.7	65.1	(49.9)	(0.3)	48.2	(29.1)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Quarterly snapshot

Margins (%)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
Gross margin	69.7	79.7	71.6	73.5	88.3	84.0	83.8	82.5	81.1	85.3
EBITDA margin	38.3	41.7	30.7	28.6	51.0	49.9	40.4	40.6	37.4	32.5
PAT margin	28.7	30.5	21.0	19.8	38.7	39.0	33.6	33.4	28.6	26.4

Source: Company, Nirmal Bang Institutional Equities Research

Financial statements

Exhibit 6: Income statement

Y/E March (Rsmn)	FY17	FY18	FY19	FY20E	FY21E
Net sales	20,202	22,020	20,945	21,916	21,403
% growth	87.0	9.0	(4.9)	4.6	(2.3)
Raw material costs	5,991	4,283	3,542	3,577	3,935
Staff costs	2,432	3,256	3,559	3,986	4,464
Other expenditure	4,945	5,197	5,896	5,917	5,779
Total expenditure	13,368	12,736	12,997	13,480	14,178
EBITDA	6,834	9,284	7,948	8,435	7,224
% growth	157.3	35.9	(14.4)	6.1	(14.4)
EBITDA margin (%)	33.8	42.2	37.9	38.5	33.8
Other income	139	404	1,302	1,497	1,722
Interest costs	185	154	193	162	164
Gross profit	14,211	17,737	17,403	18,339	17,467
% growth	75.6	24.8	(1.9)	5.4	(4.8)
Depreciation	544	662	810	961	1,061
Profit before tax	6,244	8,872	8,247	8,809	7,720
% growth	206.5	42.1	(7.0)	6.8	(12.4)
Tax	1,395	1,920	1,823	1,947	1,707
Effective tax rate (%)	22.3	21.6	22.1	22.1	22.1
Net profit	4,860	6,962	6,444	6,882	6,034
% growth	209.3	43.3	(7.4)	6.8	(12.3)
EPS (Rs)	27.9	38.8	34.9	37.3	32.7
% growth	206.4	39.2	(10.0)	6.8	(12.3)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Balance sheet

Y/E March (Rsmn)	FY17	FY18	FY19	FY20E	FY21E
Equity	349	369	365	365	365
Reserves	16,144	30,353	34,525	41,145	46,917
Net worth	16,493	30,722	34,890	41,510	47,282
Net deferred tax liabilities	150	139	116	116	116
Total debt	2,216	1,732	3,863	1,946	1,970
Other non-current liabilities	268	370	738	738	738
Liabilities	19,127	32,963	39,607	44,310	50,106
Net block	8,272	10,127	12,185	13,691	14,629
Capital WIP	3,363	4,800	6,376	6,376	6,376
Intangible assets and goodwill	58	59	87	87	87
Other non-current assets	610	858	911	911	911
Inventories	3,489	4,384	5,290	2,083	2,292
Debtors	4,752	6,375	5,062	5,155	5,034
Cash	358	1,837	2,795	8,878	13,770
Other current assets	2,274	8,711	10,325	10,311	10,309
Total current assets	10,873	21,307	23,472	26,427	31,405
Creditors	2,627	2,691	2,170	1,568	1,726
Other current liabilities	1,422	1,497	1,254	1,613	1,577
Total current liabilities	4,049	4,188	3,424	3,182	3,303
Net current assets	6,824	17,119	20,048	23,246	28,102
Total assets	19,127	32,963	39,607	44,310	50,106

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Cash flow

Y/E March (Rsmn)	FY17	FY18	FY19	FY20E	FY21E
EBIT	6,429	9,026	8,440	8,972	7,885
(Inc.)/dec. in working capital	(2,495)	(8,816)	(1,971)	2,886	35
Cash flow from operations	3,934	210	6,469	11,857	7,920
Other income	(139)	(404)	(1,302)	(1,497)	(1,722)
Depreciation	544	662	810	961	1,061
Other non-cash expenses	3	(11)	(23)	-	-
Tax paid	(1,395)	(1,920)	(1,823)	(1,947)	(1,707)
Net cash from operations	2,947	(1,463)	4,131	9,374	5,552
Capital expenditure	(3,018)	(3,955)	(4,472)	(2,467)	(2,000)
Net cash after capex	(71)	(5,418)	(341)	6,907	3,552
Other investment activities	157	156	1,249	1,497	1,722
Cash from financial activities	(180)	6,741	50	(2,321)	(383)
Opening cash balance	452	358	1,837	2,795	8,878
Closing cash balance	358	1,837	2,795	8,878	13,770
Change in cash balance	(94)	1,479	958	6,083	4,891

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Key ratios

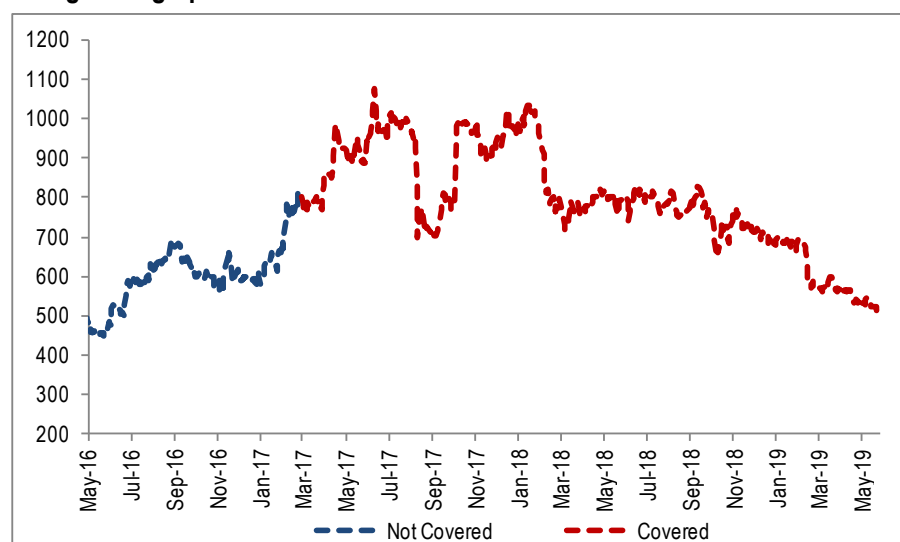
Y/E March	FY17	FY18	FY19	FY20E	FY21E
Profitability & return ratios					
EBITDA margin (%)	33.8	42.2	37.9	38.5	33.8
EBIT margin (%)	31.8	41.0	40.3	40.9	36.8
Net profit margin (%)	24.1	31.6	30.8	31.4	28.2
RoE (%)	29.5	22.7	18.5	16.6	12.8
RoCE (%)	42.6	31.4	23.3	21.8	16.8
Working capital & liquidity ratios					
Receivables (days)	86	106	88	86	86
Inventory (days)	213	374	545	213	213
Payables (days)	160	229	224	160	160
Current ratio (x)	2.7	5.1	6.9	8.3	9.5
Quick ratio (x)	1.8	4.0	5.3	7.7	8.8
Valuation ratios					
EV/sales (x)	7.5	6.1	4.5	4.1	4.0
EV/EBITDA (x)	22.3	14.6	12.0	10.7	11.8
P/E (x)	31.0	20.0	15.0	14.1	16.1
P/BV (x)	9.1	4.4	2.7	2.3	2.0

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
6 November 2018	Accumulate	752	813
14 February 2019	Buy	636	776
5 April 2019	Buy	556	779
28 May 2019	Buy	525	654

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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