

Natco Pharma

19 June 2020

Reuters: NATP.NS; Bloomberg: NTCPH IN

Domestic formulations decline due to COVID-19 impact

Financial Highlights: Natco Pharma reported revenue of Rs4548mn, which was below our/consensus estimate by 6.9%/10.1%, respectively. Revenue was down 5.7% QoQ and was flat YoY. Revenue was down because of disruption in domestic formulation sales due to Covid-19 pandemic. Oncology and Hep-C business were down due to fewer hospital visits and lower diagnosis of new cases. The phenomenon should continue to affect domestic sales in FY21. Currently, there is lack of clarity about when the demand in the domestic market will normalize.

Even promotion around its newly launched C&D portfolio stands impacted and hence ramp up may be slower. 8-10 new product launches are expected in FY21. Export formulation and API sales were steady during the quarter. Export formulation sales (excluding profit share contribution) should exhibit mid to high teens growth in FY21, led by new approvals in Brazil and Canada.

EBITDA for the quarter was Rs1,283mn, below our/consensus estimates by 17.6%/16.9%, respectively. EBITDA was down 13.5% YoY. Raw material cost was higher due to some high margin segments being down in the quarter.

PAT at Rs932mn was down 22.6% YoY and 10.7% QoQ. PAT was below our/consensus estimates by 24%/25%, respectively.

Update on key opportunities going forward

- **Revlimid approval in the US**– The scheduled target action date was in 4QFY20, but the company had received queries from the USFDA. A response has been submitted. The company is hopeful of an approval in the coming months. Revlimid brand sales in the US stand at US\$7.9bn. As per the settlement agreement, NPL is supposed to start selling generic copies in March 2022 (end of FY22).
- **Revlimid – Canada** – The trial date for litigation has been set for July 2020 and a decision in this regard can take 3 to 12 months.

Outlook and valuation: We revise our estimates on NPL as we lower our domestic growth expectations to account for the COVID-19 impact. The new launches in the C&D division also stand impacted as the much needed promotional efforts to ramp up the portfolio may not come through. NPL is the sole generic player in the market for Dapagliflozin and Apixaban. In case of Dapagliflozin, NPL has been litigated by the innovator (AstraZeneca) and a decision is currently due. In FY21, export formulation sales remain the sole growth driver. Successful approval for CTPR (insecticide) and favorable litigation outcome remain a free call option and is not in our forecasts currently. We recommend a Buy on NPL with a target price of Rs710 based on 22x FY22 EPS. We currently estimate incremental competition for gCopaxone in FY22 and this is in line with the company's guidance.

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BUY

Sector: Pharmaceuticals

CMP: Rs620

Target Price: Rs710

Upside: 15%

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Key Data

Current Shares O/S (mn)	182.1
Mkt Cap (Rsbn/US\$bn)	112.9/1.5
52 Wk H / L (Rs)	738/403
Daily Vol. (3M NSE Avg.)	398,991

Price Performance (%)

	1 M	6 M	1 Yr
Natco Pharma	5.4	6.1	20.0
Nifty Index	14.4	(17.4)	(13.7)

Source: Bloomberg

Y/E March (Rsmn)	4QFY19	3QFY20	4QFY20	YoY (%)	QoQ (%)	FY19	FY20	YoY (%)
Revenues	4,557	4,822	4,548	(0.2)	(5.7)	20,945	19,150	(8.6)
Raw material expenses	670	915	949	41.6	3.7	3,542	3,816	7.7
%age of revenues	14.7	19.0	20.9	616 bps	189 bps	16.9	19.9	302 bps
Staff costs	813	978	816	0.4	(16.6)	3,559	3,750	5.4
%age of revenues	17.8	20.3	17.9	10 bps	(234) bps	17.0	19.6	259 bps
Other expenses	1,591	1,642	1,500	(5.7)	(8.6)	5,896	5,758	(2.3)
%age of revenues	34.9	34.1	33.0	(193) bps	(107) bps	28.1	30.1	192 bps
EBITDA	1,483	1,287	1,283	(13.5)	(0.3)	7,948	5,826	(26.7)
EBITDA margin (%)	32.5	26.7	28.2	(433) bps	152 bps	37.9	30.4	(752) bps
Other income	310	308	224	(27.7)	(27.3)	1,302	1,074	(17.5)
Interest	52	53	35	(32.7)	(34.0)	193	215	11.4
Depreciation	217	254	305	40.6	20.1	810	998	23.2
Exceptional item	0.0	0	0	-	-	0	0	
PBT	1,524	1,288	1,167	(23.4)	(9.4)	8,247	5,687	(31.0)
Tax	320	244	235	(26.6)	(3.7)	1,823	1,106	(39.3)
Tax rate (%)	21.0	18.9	20.1	(86) bps	119 bps	22.1	19.4	(266) bps
PAT	1,204	1,044	932	(22.6)	(10.7)	6,444	4,608	(28.7)
PAT Margin (%)	26.4	21.7	20.5	(593) bps	(116) bps	30.8	24.1	(675) bps

Source: Company, Nirmal Bang Institutional Equities Research

Earnings conference-call takeaways

Domestic business: The domestic business was severely impacted as the Oncology and Hep-C businesses were affected due to lower demand from patients. The management expects the business to be flat in FY21. The management has guided for 8-10 product launches in FY21 given the current situation. On a longer-term horizon, the guidance is 10-12 launches per year.

Oncology business: The business was down as immunosuppressed cancer patients can be highly vulnerable to Covid-19, leading to fewer hospital visits. The oral oncology business (contributing 65-70% to Oncology business) is coming back but chemotherapy business (contributing 30-35% to Oncology business) is yet to be back as the hospital visits are still sparse. Pricing pressure is seen easing in this year which was there in 2019. EBITDA margin of the Oncology business is higher than consolidated company EBITDA margin.

Export business: The export business is growing and is offsetting the underperformance of the domestic business. The business has grown due to company having Chloroquine and Oseltamivir in portfolio, growth in oral oncology and stocking up due to Covid-19 pandemic.

US: The profit share from limited competition portfolio in the US remains stable. The company expects the current portfolio of products to drive business in the US and has only a couple of products in pipeline for the US.

Agrochemicals business: The company has filed 1 product and approval takes roughly 10-12 months. The company will be adopting a similar business model to what it does in the pharma division and challenging patents will also be a part of business strategy.

China: The company has 4-5 filings under review in China and couple of approvals are expected in the current fiscal year.

API: The company is not equipped to participate in the Government's stimulus for commodity drug API manufacturing as it is mainly engaged in manufacture of specialty intermediates.

Copaxone: Mylan's market share is up to 30% in the product. Incremental competition is expected by the end of the current fiscal.

Revlimid: In Canada, the trial for Revlimid is scheduled to commence in July. Regarding the US filing, the company has responded to all the queries raised by USFDA and incremental inspection is not expected. The management is hoping for a positive news by next quarter.

CTPR: The CTPR approval is expected soon and there is no incremental development on the ongoing court case with FMC.

Inventory: Given the current situation, the company is maintaining an inventory of 8-9 months in key products.

Exhibit 1: Actual performance versus our/Bloomberg consensus estimates

(Rsmn)	Actual	NBIE estimate	Var. (%)	Consensus estimate	Var. (%)
Sales	4,548	4,886	(6.9)	5,059	(10.1)
EBITDA	1,283	1,557	(17.6)	1,543	(16.9)
EBITDA margin (%)	28.2	31.9	(367) bps	30.5	(229) bps
Reported PAT	932	1,225	(23.9)	1,241	(24.9)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Revised Estimates

Rsmn	New estimates		Old estimates		Change (%)	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Net sales	19,861	22,531	20,566	22,278	(3.4)	1.1
EBITDA	6,098	7,398	6,884	7,557	(11.4)	(2.1)
Margin (%)	30.7	32.8	33.5	33.9	(277) bps	(109) bps
PAT	4,794	5,871	5,469	6,063	(12.3)	(3.2)
Margin (%)	24.1	26.1	26.6	27.2	(245) bps	(116) bps
EPS	26.4	32.3	30.1	33.3	(12.3)	(3.2)

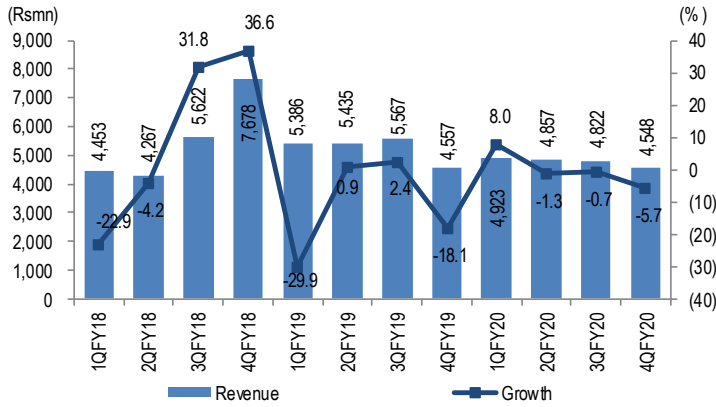
Source: Nirmal Bang Institutional Equities Research

Exhibit 3: Key financials

Y/E March (Rsmn)	FY18	FY19	FY20	FY21E	FY22E
Net sales	22,020	20,945	19,150	19,861	22,531
EBITDA	9,284	7,948	5,826	6,098	7,398
Net profit	6,962	6,444	4,608	4,794	5,871
EPS (Rs)	39.1	35.4	25.3	26.4	32.3
EPS growth (%)	40.2	(9.4)	(28.5)	4.0	22.5
EBITDA margin (%)	42.2	37.9	30.4	30.7	32.8
P/E (x)	19.9	17.0	24.5	23.5	19.2
P/BV (x)	4.4	3.1	3.0	2.7	2.4
EV/EBITDA (x)	14.6	13.6	19.8	18.3	14.6
RoCE (%)	30.8	22.8	14.8	14.6	16.0
RoE (%)	22.7	18.5	12.2	11.3	12.3

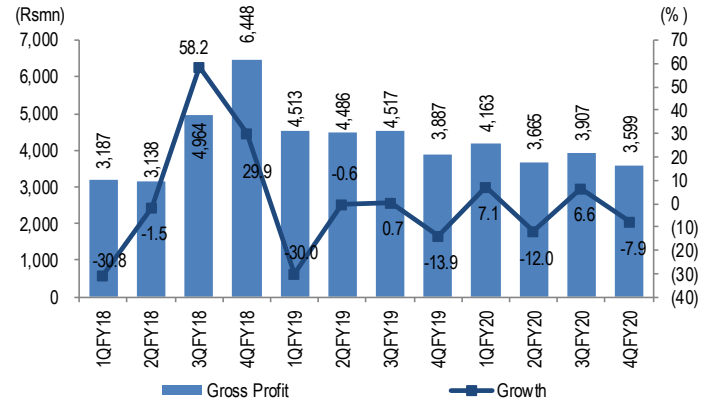
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Revenue and growth trend



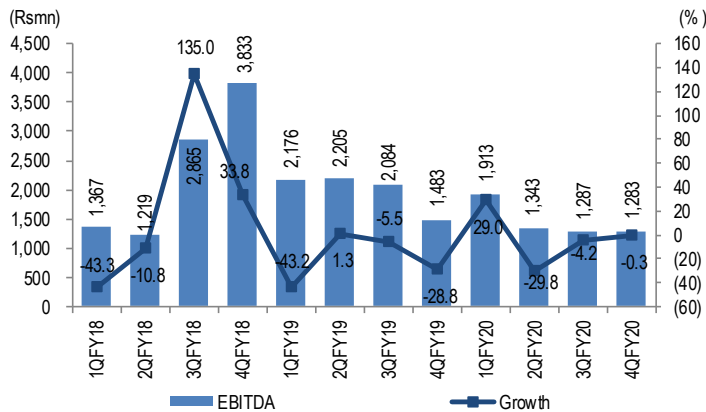
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Gross profit and growth trend



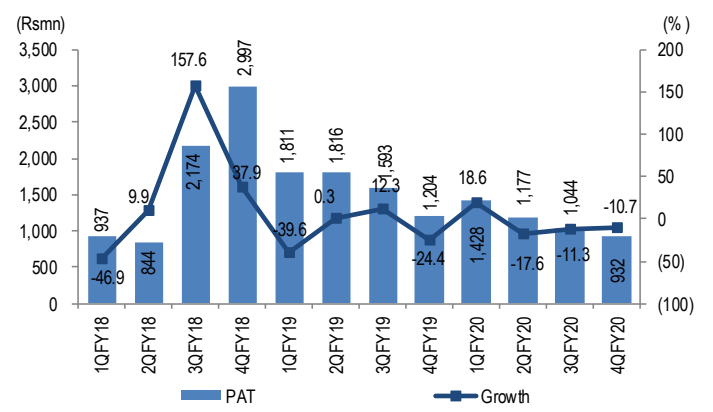
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: EBITDA and growth trend



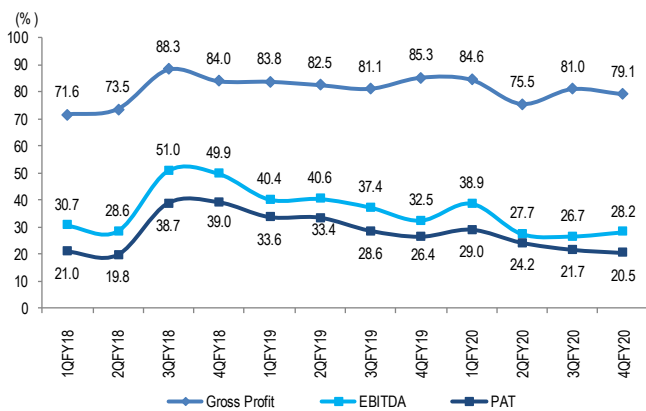
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: PAT and growth trend



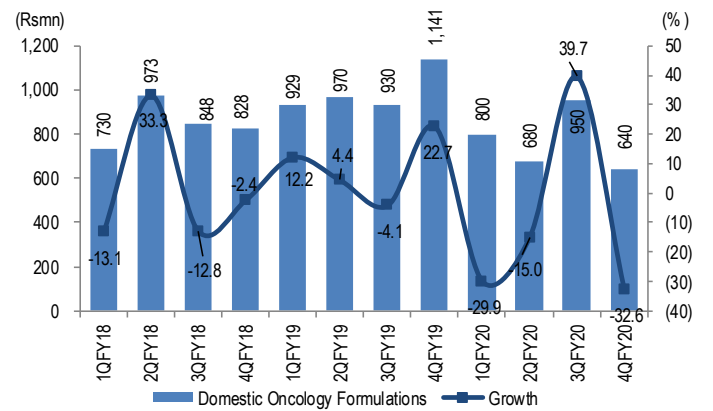
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Margin trend



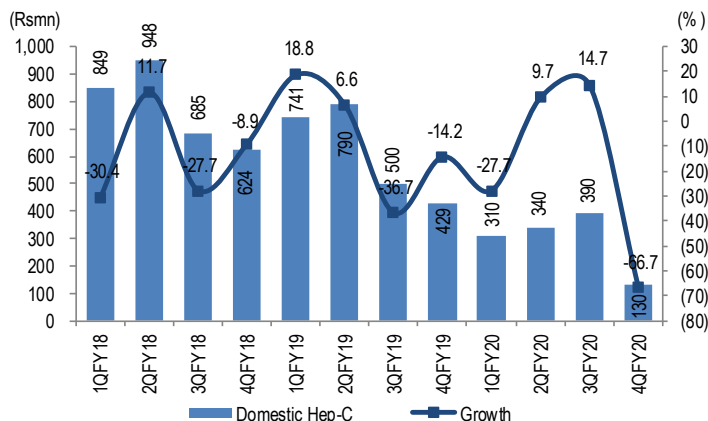
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Domestic Oncology revenue and growth trend



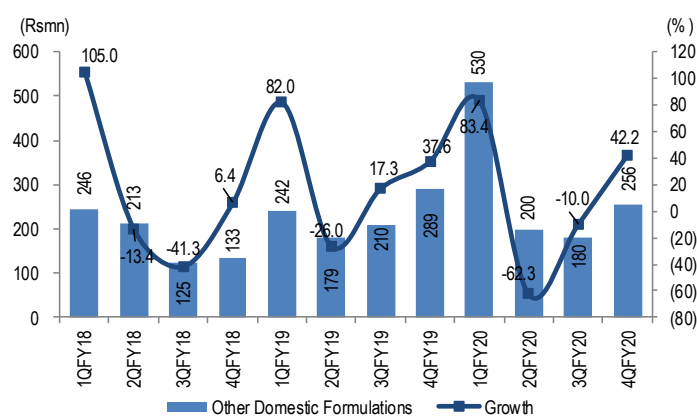
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Domestic Hep-C revenue and growth trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Other Domestic (C&D) revenue and growth trend



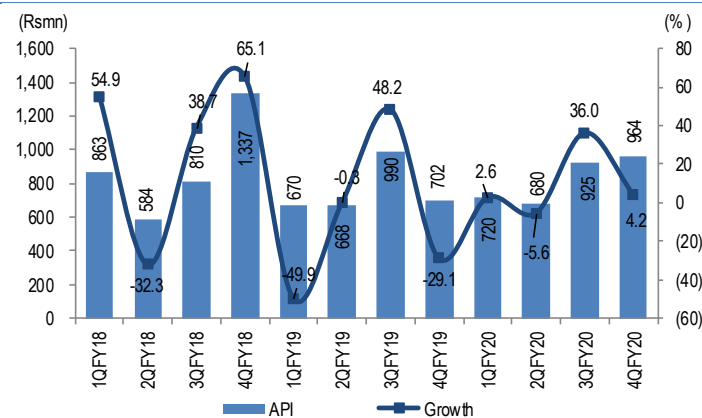
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Export formulations revenue and growth trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: API revenue and growth



Source: Company, Nirmal Bang Institutional Equities Research

Financial statements
Exhibit 14: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20	FY21E	FY22E
Net sales	22,020	20,945	19,150	19,861	22,531
% growth	9.0	(4.9)	(8.6)	3.7	13.4
Raw material costs	4,283	3,542	3,816	3,961	4,464
Staff costs	3,256	3,559	3,750	3,938	4,410
Other expenditure	5,197	5,896	5,758	5,865	6,259
Total expenditure	12,736	12,997	13,324	13,763	15,133
EBITDA	9,284	7,948	5,826	6,098	7,398
% growth	35.9	(14.4)	(26.7)	4.7	21.3
EBITDA margin (%)	42.2	37.9	30.4	30.7	32.8
Other income	404	1,302	1,074	1,346	1,547
Interest costs	154	193	215	157	177
Gross profit	17,737	17,403	15,334	15,900	18,067
% growth	24.8	(1.9)	(11.9)	3.7	13.6
Depreciation	662	810	998	1,167	1,267
Profit before tax	8,872	8,247	5,687	6,120	7,502
% growth	42.1	(7.0)	(31.0)	7.6	22.6
Tax	1,920	1,823	1,106	1,346	1,650
Effective tax rate (%)	21.6	22.1	19.4	22.0	22.0
Net profit	6,962	6,444	4,608	4,794	5,871
% growth	43.3	(7.4)	(28.5)	4.0	22.5
EPS (Rs)	39.1	35.4	25.3	26.4	32.3
% growth	40.2	(9.4)	(28.5)	4.0	22.5

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Balance sheet

Y/E March (Rsmn)	FY18	FY19	FY20	FY21E	FY22E
Equity	369	365	364	364	364
Reserves	30,353	34,525	37,371	41,903	47,512
Net worth	30,722	34,890	37,735	42,267	47,876
Net deferred tax liabilities	139	116	259	259	259
Total debt	1,732	3,863	3,159	2,302	1,952
Other non-current liabilities	370	738	1,022	1,022	1,022
Liabilities	32,963	39,607	42,175	45,849	51,109
Net block	10,127	12,185	15,756	16,590	17,324
Capital WIP	4,800	6,376	5,180	5,180	5,180
Intangible assets and goodwill	59	87	88	88	88
Other non-current assets	858	911	1,598	1,598	1,598
Inventories	4,384	5,290	5,580	5,791	6,527
Debtors	6,375	5,062	5,513	5,718	6,486
Cash	1,837	2,795	660	3,276	6,777
Other current assets	8,711	10,325	11,503	11,470	11,477
Total current assets	21,307	23,472	23,256	26,255	31,268
Creditors	2,691	2,170	2,554	2,376	2,678
Other current liabilities	1,497	1,254	1,149	1,485	1,671
Total current liabilities	4,188	3,424	3,703	3,862	4,349
Net current assets	17,119	20,048	19,553	22,394	26,919
Total assets	32,963	39,607	42,175	45,849	51,109

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Cash flow

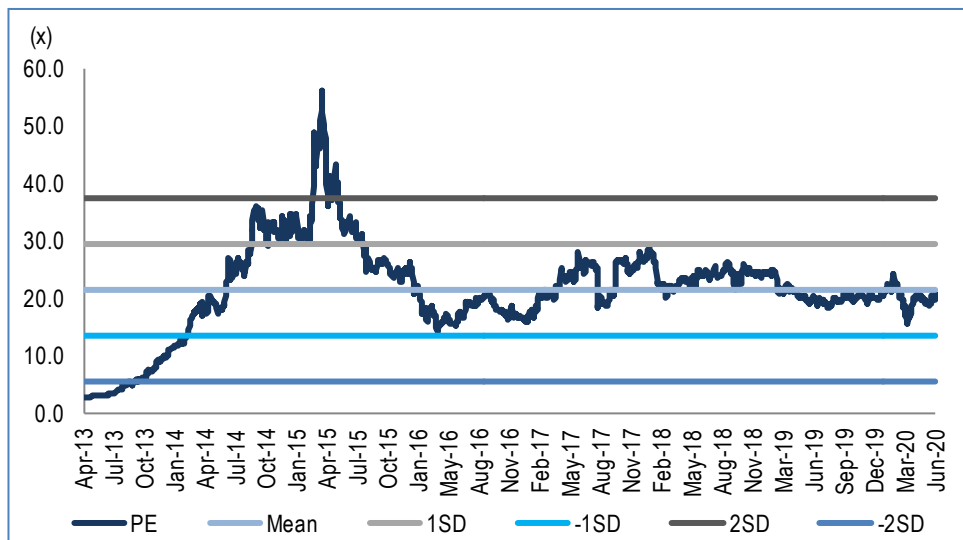
Y/E March (Rsmn)	FY18	FY19	FY20	FY21E	FY22E
PBT	8,872	8,247	5,687	6,120	7,502
(Inc.)/Dec in working capital	(2,947)	88	(976)	(225)	(1,024)
Cash flow from operations	5,925	8,335	4,711	5,895	6,478
Other income	(249)	(898)	(791)	(1,346)	(1,547)
Depreciation	662	810	998	1,167	1,267
Other non-Cash Expenses	343	229	333	157	177
Tax paid	(2,045)	(1,788)	(1,078)	(1,346)	(1,650)
Net cash from operations	4,636	6,688	4,173	4,527	4,724
Capital expenditure	(4,065)	(4,439)	(3,365)	(2,000)	(2,001)
Net cash after capex	571	2,249	808	2,527	2,723
Other investing activities	(7,090)	(1,683)	1,695	1,346	1,547
Cash from Financial Activities	6,501	(500)	(2,588)	(1,256)	(769)
Opening cash	235	217	283	660	3,276
Closing cash	217	283	198	3,276	6,777
Change in cash	(18)	66	(85)	2,616	3,501

Source: Company, Nirmal Bang Institutional Equities Research

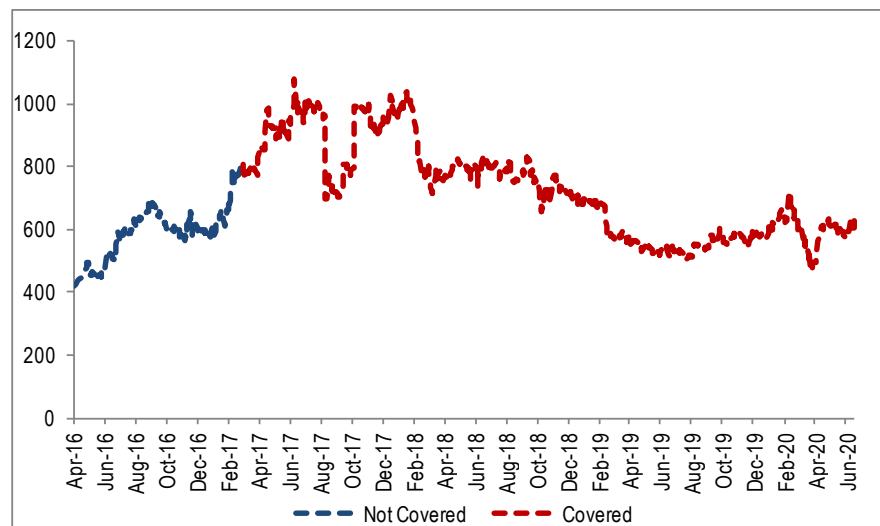
Exhibit 17: Key ratios

Y/E March	FY18	FY19	FY20	FY21E	FY22E
Profitability & return ratios					
EBITDA margin (%)	42.2	37.9	30.4	30.7	32.8
EBIT margin (%)	40.3	39.4	29.7	30.8	33.3
Net profit margin (%)	31.6	30.8	24.1	24.1	26.1
RoE (%)	22.7	18.5	12.2	11.3	12.3
RoCE (%)	30.8	22.8	14.8	14.6	16.0
Working capital & liquidity ratios					
Receivables (days)	106	88	105	105	105
Inventory (days)	374	545	534	534	534
Payables (days)	229	224	244	219	219
Current ratio (x)	5.1	6.9	6.3	6.8	7.2
Quick ratio (x)	4.0	5.3	4.8	5.3	5.7
Valuation ratios					
EV/sales (x)	6.1	5.2	6.0	5.6	4.8
EV/EBITDA (x)	14.6	13.6	19.8	18.3	14.6
P/E (x)	19.9	17.0	24.5	23.5	19.2
P/BV (x)	4.4	3.1	3.0	2.7	2.4

Source: Company, Nirmal Bang Institutional Equities Research

P/E Chart

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
13 August 2019	Buy	552	654
23 September 2019	Buy	565	747
13 November 2019	Buy	580	747
14 February 2020	Accumulate	675	685
27 March 2020	Buy	477	710
23 April 2020	Buy	608	710
19 June 2020	Buy	620	710

Rating track graph


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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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