

Natco Pharmaceuticals Ltd: Q1FY18 Result Update

In line with expectations

CMP INR 922

Target INR 1213

Rating: BUY

Upside: 32%

Natco Pharmaceuticals Ltd (NPL) reported a topline of INR 428 crs, which is 5% higher than our estimates. The strong uptick in numbers has been primarily on account of incremental profit sharing from gTAMIFLU launch in the US coupled with strong API inflows. In fact, revenue from gTAMIFLU contributed nearly 17% to the total revenues during the quarter. The domestic business, on the contrary, de-grew by 20% due to pre-GST inventory clearance by dealers and institutions. The company reported an adjusted PAT of INR 94 crs, 12% ahead of our estimate of INR 84 crs. The management continues to guide for strong uptick in its domestic business on the back of new launches in the cardiology and anti-diabetes portfolio as well as continued traction in its oncology and Hepatitis C business. Additionally, its US pipeline with near-term focus on gCOPAXONE, gFOSRENOL and gBOSENTAN remains as one of the key growth drivers. We believe, steady ramp-up in gDOXIL LIPOSOMAL as well as approval for gCOPAXONE will aid in sustaining US revenues despite significant competition eroding market for existing products including gTAMIFLU. Hence, the stock would continue to command a premium in the pharma space and remains a strong BUY.

Extended gains from gTAMIFLU; but opportunity remains one-time

NPL reported extended gains from gTAMIFLU capsule through profit sharing from Alvogen leveraging upon its near 75-day exclusivity for the drug up to February, 2017. Post booking formulation sales (from inventory) of INR 230 cr and profit sharing of INR 465 cr during FY17, NPL added about INR 72 cr from profit sharing revenue during Q1FY18. Going forward, in H2FY18, NPL is expected to get approvals for gTAMIFLU suspension which is an expected \$350 million market. This will create some opportunity to slightly offset the price competition which could reduce gTAMIFLU capsule overall business in FY18 to nearly one-fifth of its FY17 contribution.

GST setback in domestic sales for the quarter; overall guidance remains strong

NPL witnessed near 20% fall y-o-y in its quarterly revenues from domestic business. However, the impact is expected to be one-time on account of inventory clearance by dealers and institutions ahead of GST implementation leading to 40-45 days of zero sales. Infact, strong traction in its oncology and Hep-C business coupled with multiple niche launches expected in the cardiology and diabetology business is expected to drive annual double-digit growth in the domestic market leading to its targeted revenue of ~INR 1000 cr for FY18.

Limited niche opportunities as delayed timelines erode opportunity size

While the company launched Doxorubicin Liposomal in Q1FY18, revenues from the same is expected to come from Q2FY18. Future launch pipeline like gVIDAZA in Q2FY18 has reduced in opportunity size due to multiple generic entries causing higher price erosion and lower market share. However, launch of gCOPAXONE (20mg & 40mg), and gFOSRENOL in the US over the next 15 months continue to look attractive. The company also expects to gain from the launch of its Hep-C portfolio in 12 of the 30 developing markets filed taking its overall (domestic + exports) growth from Hep-C to 15-20% y-o-y in FY18 and FY19 notwithstanding domestic competition. While NPL has a strong US pipeline, its R&D focus in developed markets has narrowed down to highly niche opportunities involving manufacturing complexity to ensure limited competition and lower price erosion.

Valuations

We continue to believe NPL is headed for exciting times ahead, with multiple launches lined up in India, the US, EU and developing markets. Ergo, we estimate stable cash flows, improvement in margins and steady growth in the domestic market. Our earnings estimate for FY18E/FY19E is 33.2/35.5 per share. We value the company's base business at 22x FY19E earnings of INR 35.5/share, while the expected launches in the US and EU are valued at INR 419/share. We maintain "BUY" recommendation on the stock, with a target price of INR 1,213/share.

Year to March	Q1FY18	Q1FY17	% Change	Q4FY17	% Change	FY17	FY18E	FY19E
Net Revenue (INR. Cr)	428	325	31.6	577	(25.8)	2,065	2,271	2,430
Growth (%)						91%	10%	7%
EBITDA (INR Cr)	137	77	77.0	241	(43.2)	683	840	899
Growth (%)						157%	23%	7%
Adj. Net Profit (INR Cr)	94	47	98.9	176	(46.6)	485	579	618
Growth (%)						216%	19%	7%
Adj. Diluted EPS (INR)	5	3		10		28	33	35
Diluted P/E (x)						34.2	28.7	26.9
EV/EBITDA (x)						24.6	19.4	17.6
RoE (%)						33%	30%	25%

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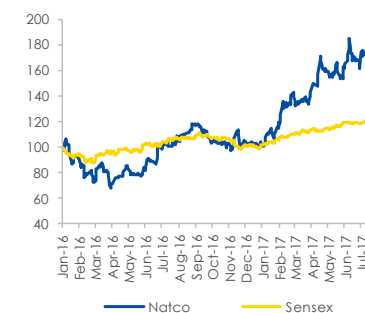
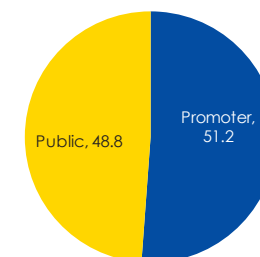
52-week range (INR): 1,090 / 500

Share in issue (cr): 17.4

M cap (INR cr): 16,749

Avg. Daily Vol. 80

BSE/NSE :('000):



Date: 8th August 2017

Q1FY18 Result Highlights

(INR Cr)	Q1FY18	Q1FY17	% Change	Q4FY17	% Change	FY17	FY18E	FY19E
Net Revenues	428	325	31.6	577	(25.8)	2,065	2,271	2,430
Raw Materials Cost	109	93	18.0	117	(6.7)	599	462	495
Gross Profit	319	233	37.1	460	(30.7)	1,466	1,809	1,936
Employee Expenses	63	50	26.8	80	(20.7)	243	259	277
Other Expenses	119	106	12.7	140	(15.0)	539	709	759
Operating Expenses	182	155	17.2	220	(17.1)	783	969	1,037
EBITDA	137	77	77.0	241	(43.2)	683	840	899
EBITDA margin	31.9%	23.8%		41.7%		33.1%	37.0%	37.0%
Depreciation	15	13	14.1	14	11.1	54	68	76
Other income	3	5	(34.1)	(1)	(666.7)	14	14	14
Exceptional Expenses	-	-				-	-	1
Net finance expense	4	3	21.9	6	(39.1)	19	27	27
Profit before tax	121	66	83.5	220	(44.9)	624	759	810
Provision for taxes	28	19	47.6	44	(37.8)	140	180	193
Reported net profit	94	47	97.6	176	(46.7)	485	579	618
Adj net profit (incl minority int.)	94	47		176		485	579	617
As % of net revenues								
COGS	26	29		20		29	20	20
Employee cost	15	15		14		12	11	11
Other Expenses	28	32		24		26	31	31
Operating expenses	43	48		38		38	43	43
EBITDA	32	24		42		33	37	37
Reported net profit	22	15		30		23	25	25
Tax rate (% of PBT)	23	28		20		22	24	24

Key Takeaways from the Concall

International

- Profit sharing income from gTamiflu led to formulations export sales growth of 162% at INR 134 cr
- All queries regarding gCopaxone have been answered to US FDA; approval awaited
- gDoxil Liposomal to contribute significantly to topline Q2FY18 onwards
- gVidaza opportunity has reduced significantly due to presence of 4 more generic players
- New ANDA filings for FY18 and futures years also to be in low single digits as company to narrow its focus to apply for highly niche opportunity with manufacturing complexity to ensure delayed competition and higher realization potential

Domestic

- GST impact led to 40-45 days of no sales; however, recovery has been quick and will reflect in revenues Q2FY18 onwards
- R&D focus turned from nearly 60% towards US filings to the same towards domestic launches now
- Increasing focus towards India due to low-competition; large opportunity in niche product segments
- 4 products launched in cardiology and anti-diabetes portfolio; several niche filings to follow in the next 12 months
- Overall debt of INR 156 cr including bills discounting with cash (including investments) of INR 209 cr. However, net debt for the year is expected to be ~INR 100 cr as the company has plans to partly fund its capex plans through borrowing.
- Capex planned for oral expansion in Guwahati, oncology API expansion and Visakhapatnam facility setup for exports

Company Description

Natco Pharma Ltd. (NPL), incorporated in September 1981 by V.C Nannapaneni, started out as a contract manufacturer for various companies in the Pharmaceutical Industry, including Ranbaxy Laboratories Ltd, Cadila Ltd and John Wyeth India Ltd among others. The company has the distinction of introducing the time release technology in India and manufactured formulations in conventional as well as sustained release forms. The company made its foray into the oncology segment in 2003 with the launch of the generic version of Imatinib Mesylate under the name 'Veenat', this was followed by Zoldonat and Letronat tablets, today, NPL is a leader in the oncology space, with 30% market share in the domestic oncology segment.

The company has established an R&D centre in Hyderabad for synthetic chemistry, biotech and fermentation.

Investment Theme

NPL is a market leader in the domestic generic oncology market, with a market share of ~23%, coupled with Hep-C, with a market share of ~35%. Although US filings remain an attractive opportunity, its sustainable growth driver is its domestic and ROW business where it continues to add products with increasing market share and consistent cash flows over the next several years. Copaxone, one of the products from its basket of niche products, has already cleared regulatory hurdles and is currently awaiting USFDA approval. We believe the pipeline for the company in both domestic and regulated markets is strong enough to get incremental and sustainable growth going forward. We believe that management's strong focus on R&D and emphasis on difficult to manufacture products would continue to support growth going forward.

Key Risks

Delay in approvals from USFDA

Much of NPL's growth is expected to be driven by the US market. So, any delay in approvals from the USFDA would impact our earnings estimates.

Adverse court ruling

Many of NPL drugs are currently under litigation in the US courts, any adverse ruling would have an impact on our estimates.

Increased Competition

Most of NPL drugs are niche in nature with limited competition, but over time there could be further players entering the market and thus impacting the earnings.

Currency risk

Around 50% of revenues for the company are from export markets, and this contribution is expected to rise further. Any adverse movements in currency could impact our earnings estimates.

Financials

						(INR cr)					(INR cr)					Profitability & Efficiency Ratios							
						Balance Sheet																	
Year to March	FY15	FY16	FY17	FY18E	FY19E	As on 31st March	FY15E	FY16E	FY17	FY18E	FY19E	Year to March	FY15E	FY16E	FY17	FY18E	FY19E	Year to March	FY15E	FY16E	FY17	FY18E	FY19E
Net revenue	840	1,080	2,065	2,271	2,430	Equity capital	33	35	35	35	35	ROA (%)	20.7%	14.5%	32.8%	30.0%	24.6%	ROA (%)	20.7%	14.5%	32.8%	30.0%	24.6%
Materials costs	242	271	599	462	495	Reserves & surplus	818	1,266	1,619	2,176	2,771	ROACE (%)	18.2%	17.5%	39.2%	36.5%	30.7%	ROICE (%)	18.2%	17.3%	38.9%	36.3%	30.5%
Gross profit	597	810	1,466	1,809	1,936	Borrowings	312	99	222	222	222	Inventory day	87	98	88	88	88	Debtors days	68	77	68	68	68
Employee costs	137	180	243	259	277	Deferred Tax Liabilities (Net)	12	15	15	15	15	Payable days	79	100	85	85	85	Current ratio	2.6	2.1	2.6	3.3	4.0
R & D Expenses	13	15	31	33	35	Sources of funds	1,175	1,414	1,891	2,448	3,044	Cash conversion cycle (days)	75	74	71	71	71	Debt/Equity	0.4	0.1	0.1	0.1	0.1
S G & A Expenses	221	349	508	676	724	Net Fixed Assets	839	932	1,182	1,265	1,340	Turnover Ratios											
EBITDA	227	266	683	840	899	Investments	2	22	32	32	32	Year to March	FY15E	FY16E	FY17	FY18E	FY19E	Total asset turnover	0.7	0.7	1.0	0.8	0.7
Depreciation & Amortization	47	51	54	68	76	Inventories	220	357	349	546	584	Fixed asset turnover	1.0	1.2	2.0	1.9	1.9	Equity turnover	1.1	1.0	1.4	1.2	1.0
EBIT	180	215	629	773	823	Sundry debtors	192	262	475	423	453	Du Pont Analysis											
Other income	19	10	14	14	14	Cash & Bank Balances	13	24	24	503	969	Year to March	FY15E	FY16E	FY17	FY18E	FY19E	NP margin (%)	19.5%	14.4%	23.5%	25.5%	25.4%
EBIT incl. other income	199	224	643	786	837	Loans and advances	118	224	255	332	355	Total assets turnover	0.7	0.7	1.0	0.8	0.7	Total assets turnover	0.7	0.7	1.0	0.8	0.7
Interest expenses	32	23	19	27	27	Total current assets	543	867	1,103	1,804	2,361	Leverage multiplier	1.6	1.5	1.4	1.4	1.4	Leverage multiplier	1.6	1.5	1.4	1.4	1.4
Profit before tax	168	201	624	759	810	Sundry creditors and others	198	393	403	527	564	ROAE (%)	20.7%	14.5%	32.8%	30.0%	24.6%	ROAE (%)	20.7%	14.5%	32.8%	30.0%	24.6%
Provision for tax	4	48	140	180	193	Provisions	11	14	24	24	24	Valuation Parameters											
Adj. Net profit	164	154	485	579	618	Total current liabilities & provisions	209	407	427	551	588	Year to March	FY15E	FY16E	FY17	FY18E	FY19E	Diluted EPS (Rs.)	9.4	8.8	27.8	33.2	35.5
Reported Net Profit	164	156	485	579	618	Net current assets	334	460	676	1,253	1,773	Y o Y growth (%)	32.6%	-6.1%	215.7%	19.4%	6.7%	Y o Y growth (%)	32.6%	-6.1%	215.7%	19.4%	6.7%
Basic shares outstanding (crs)	17.42	17.42	17.42	17.42	17.42	Uses of funds	1,175	1,414	1,891	2,550	3,146	Diluted PE (x)	111.8	108.1	34.2	28.7	26.9	Diluted PE (x)	111.8	108.1	34.2	28.7	26.9
EPS (Rs.)	9.4	8.8	27.8	33.2	35.5	Book value per share (Rs.)	49	74	95	127	161	Price/BV (x)	19.6	12.8	10.1	7.5	5.9	Price/BV (x)	19.6	12.8	10.1	7.5	5.9
Dividend per share (Rs.)	1.1	1.5	1.5	1.5	1.5	Free cash flow	(INR cr)					EV/Sales (x)	19.8	15.4	8.1	7.0	6.3	EV/Sales (x)	19.8	15.4	8.1	7.0	6.3
Dividend payout (%)	12.2%	17.1%	5.4%	4.5%	4.2%	Year to March	FY15E	FY16E	FY17	FY18E	FY19E	EV/EBITDA (x)	74.4	62.8	24.6	19.4	17.6	EV/EBITDA (x)	74.4	62.8	24.6	19.4	17.6
Common Size						Net profit	148	154	485	579	618	Dividend yield (%)	0.1%	0.2%	0.2%	0.2%	0.2%	Dividend yield (%)	0.1%	0.2%	0.2%	0.2%	0.2%
Year to March	FY15	FY16	FY17	FY18E	FY19E	Add : Depreciation	47	51	54	68	76												
Materials costs	28.9%	32.2%	71.3%	55.0%	58.9%	Others	(22)	(83)	5	13	13												
Employee expenses	16.3%	21.4%	29.0%	30.9%	33.0%	Gross cash flow	174	121	544	660	707												
Manufacturing & Other Expenses	26.3%	41.6%	60.5%	80.6%	86.2%	Less: Changes in WC	(86)	(115)	(227)	(97)	(54)												
Research & Development Expenses	1.5%	1.8%	3.7%	3.9%	4.2%	Operating cash flow	88	6	317	562	652												
Depreciation	5.6%	4.7%	2.6%	3.0%	3.1%	Less: Capex	125	137	304	150	151												
EBITDA margins	27.1%	24.6%	33.1%	37.0%	37.0%	Free cash flow	(37)	(131)	13	412	501												
EBIT margins	21.4%	19.9%	30.5%	34.0%	33.9%	Cash Flow Statement	(INR cr)																
Net profit margins	19.5%	14.4%	23.5%	25.5%	25.4%	Year to March	FY15E	FY16E	FY17	FY18E	FY19E												
Growth Ratios						Cash flow from operations	88	102	317	562	652												
Year to March	FY15	FY16	FY17	FY18E	FY19E	Cash Flow from investing activities	(115)	(175)	(300)	(136)	(137)												
Revenues	10.6%	28.6%	91.2%	10.0%	7.0%	Cash Flow from financing activities	29	86	83	(49)	(49)												
EBITDA	13.7%	16.9%	157.3%	23.0%	7.0%	Capex	(125)	(137)	(304)	(150)	(151)												
PBT	8.7%	20.2%	209.9%	21.6%	6.7%	Dividends	(17)	(17)	(22)	(22)	(22)												
Net profit	32.6%	-6.1%	215.7%	19.4%	6.7%																		

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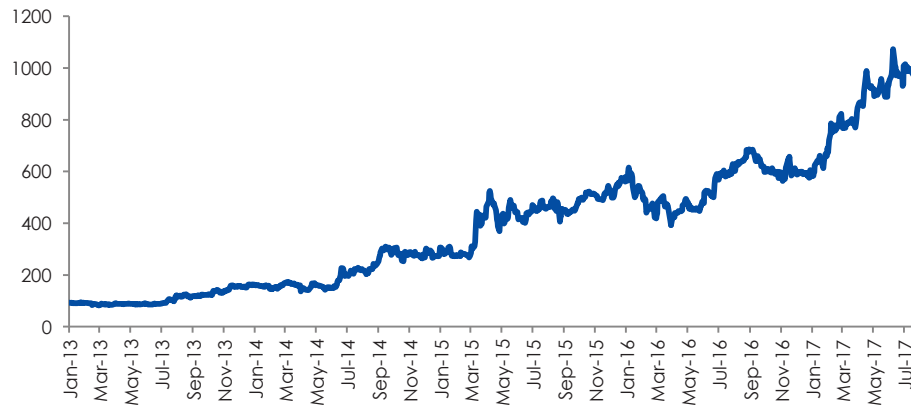
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Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate between 5-15% over a 12-month period
Reduce	Return below 5% over a 12-month period

Natco Pharma 5 years price chart



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