

Sector update

- Cipla (BUY)
- Dr Reddy's (ADD)
- Natco (HOLD from Add)

INDIA

Pharmaceuticals

Increasing competition for generic *Revlimid*

Cipla has announced settlement of patent litigation with Celgene (subsidiary of Bristol Myers Squibb) for *Revlimid* (lenalidomide). It has become the fourth company to have settled litigations pertaining to this product after Natco Pharma, Dr Reddy's Lab, and Alvogen. Additional settlements with other companies also remain a possibility. Cadila, Apotex, Sun Pharma, Hetero, Mylan and Aurobindo are the other Para IV filers for it. *Revlimid*'s brand sales in the US stood at over US\$6bn in 9MCY20. We believe restriction on volume market share as per settlements will help minimise the impact of growing competition. As per latest information, Natco would launch first in Mar'22 followed by the other three companies whose timelines have not been disclosed.

► **Four companies have settled *Revlimid* litigation; more may follow:** Natco, Alvogen, Dr Reddy's, and Cipla have settled their respective litigations, in that specific order, for launching generic *Revlimid*. There are six more para IV filers and we may observe more of these settlements going forward depending on positioning of generic companies in the litigations. Natco (Teva is the marketing partner) would be the first company to launch generic *Revlimid* in Mar'22 and, as per the settlement, it would be the best positioned to monetise this opportunity. Terms of the settlement for these companies are as below:

Natco/Teva (settled in Dec'15) will launch generic *Revlimid* in Mar'22 with volume market share constraint of mid-single digit in the first full year of launch, with volumes gradually increasing to no more than one-third market share in final year of the settlement deal. Later, unlimited volumes can be sold from 31st Jan'26.

Alvogen (settled in Mar'19) will launch on an undisclosed date after Natco and will have volume market share constraint, with volumes gradually increasing to no more than single-digit share in the final year of deal. Later, unlimited volumes can be sold from 31st Jan'26.

Dr Reddy's (settled in Sep'20) will launch on an undisclosed date after Natco and will have volume market share constraints, which remain undisclosed, up to 31st Jan'26. Later, unlimited volumes can be sold from 31st Jan'26.

Cipla (settled in Dec'20) will launch on an undisclosed date after Natco and will have volume market share constraints, which remain undisclosed, until 31st Jan'26. Later, unlimited volumes can be sold from 31st Jan'26.

► **Impact on stocks:** Key point is volume market share constraints in all settlements, which would help limit the impact of growing competition. However, price erosion could be higher than prior estimates. Hence, we increase our price erosion estimates and marginally lower opportunity value for Dr Reddy's and Natco Pharma.

Cipla: We add Rs28/share for *Revlimid* opportunity, hence we raise the target price to Rs938/share (earlier: Rs910) and maintain **BUY** on the stock.

Dr Reddy's Lab: We lower the *Revlimid* opportunity value by Rs73/share, assuming higher price erosion. We maintain **ADD** with a revised target price of Rs5,412/share (earlier: Rs5,485/share).

Natco Pharma: We lower the *Revlimid* opportunity value by Rs24/share, assuming higher price erosion. Considering the recent run-up in stock price, we downgrade it to **HOLD** from **Add** with a revised target price of Rs974/share (earlier: Rs998/share).

Valuation summary

Company	Reco	CMP	TP	P/E (x)			EV/EBITDA (x)			RoE (%)		
		(Rs)	(Rs)	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Cipla	Buy	756	938	26.3	23.1	20.2	14.0	12.4	10.6	13.8	13.9	14.0
Dr Reddy's	Add	5,016	5,412	30.1	26.4	18.0	17.4	15.2	10.6	16.6	16.6	21.0
Natco	Hold	951	974	31.1	30.3	14.1	23.0	22.1	10.2	14.0	12.9	24.0

Source: I-Sec research

Cipla financial summary (consolidated)

Table 1: Profit & Loss statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Domestic formulations	67,410	75,743	84,533	93,667
Export formulations	92,420	104,343	112,288	120,645
APIs	7,520	8,272	9,099	10,009
Other op. Income	3,970	2,779	2,779	2,779
Total Gross Sales	171,320	191,137	208,699	227,100
Excise duty	-	-	-	-
Total Net Revenue	171,320	191,137	208,699	227,100
YoY Growth%	4.7	11.6	9.2	8.8
Total Op. Exp.	138,735	148,609	162,263	175,435
EBITDA	32,585	42,528	46,435	51,665
Margins %	19.0	22.3	22.3	22.8
YoY Growth%	5.2	30.5	9.2	11.3
Depreciation	11,747	11,124	11,799	12,474
EBIT	20,838	31,404	34,637	39,191
Other Income	3,442	2,328	2,423	2,527
Interest	1,974	1,540	970	490
EO Items	(525)	0	0	0
PBT	21,782	32,192	36,090	41,228
Tax	6,312	9,014	9,744	11,132
Tax Rate (%)	29.0	28.0	27.0	27.0
Minority Interest	5	0	0	0
Reported PAT	15,465	23,178	26,345	30,097
Adj. PAT	15,838	23,178	26,345	30,097
Net Margins (%)	9.2	12.1	12.6	13.3

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Paid-up Capital	1,613	1,613	1,613	1,613
Reserves & Surplus	156,018	176,286	199,722	226,909
Total Equity	157,630	177,899	201,335	228,522
Minority Interest	2,943	2,943	2,943	2,943
Total Debt	28,164	23,164	9,164	7,164
Deferred Liabilities	1,254	1,254	1,254	1,254
Capital Employed	189,992	205,260	214,696	239,883
Current Liabilities	44,236	50,784	54,529	58,809
Total Liabilities	234,228	256,045	269,225	298,692
Net Fixed Assets	107,424	103,800	99,501	94,527
Investments	2,195	2,195	2,195	2,195
Inventory	43,776	46,891	51,200	55,356
Debtors	38,913	43,414	47,403	51,583
Other Current Assets	21,715	23,682	25,426	27,252
Cash and Equivalents	20,204	36,061	43,500	67,778
Total Cur. Assets	124,609	150,049	167,529	201,969
Total Assets	234,228	256,045	269,225	298,692

Source: Company data, I-Sec research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
PBT (Adj. for Extraordinary)	21,782	32,192	36,090	41,228
Depreciation	11,747	11,124	11,799	12,474
Net Chg in WC	3,730	(3,137)	(6,385)	(5,977)
Taxes	(8,483)	(9,014)	(9,744)	(11,132)
Others	(65)	101	90	94
CFO	28,711	31,267	31,849	36,688
Capex	(10,177)	(7,500)	(7,500)	(7,500)
Net Investments made	12,100	-	-	-
Others	(882)	-	-	-
CFI	1,040	(7,500)	(7,500)	(7,500)
Change in Share capital	1	-	-	-
Change in Debts	(17,382)	(5,000)	(14,000)	(2,000)
Div. & Div Tax	(6,642)	(2,910)	(2,910)	(2,910)
Others	(1,878)	-	-	-
CFF	(25,900)	(7,910)	(16,910)	(4,910)
Total Cash Generated	3,851	15,857	7,439	24,278
Cash Opening Balance	6,188	10,039	25,896	33,335
Cash Closing Balance	10,039	25,896	33,335	57,613

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
Adj EPS	19.6	28.7	32.7	37.3
YoY Growth%	(2.0)	46.3	13.7	14.2
Cash EPS	21.6	30.7	33.9	37.9
EBITDA (%)	19.0	22.3	22.3	22.8
NPM (%)	9.2	12.1	12.6	13.3
Net Debt to Equity (x)	0.1	(0.1)	(0.2)	(0.3)
P/E (x)	38.5	26.3	23.1	20.2
EV/EBITDA (x)	18.9	14.0	12.4	10.6
P/BV (x)	3.9	3.4	3.0	2.7
EV/Sales (x)	3.6	3.1	2.8	2.4
RoCE (%)	8.5	11.9	12.4	13.0
RoE (%)	10.3	13.8	13.9	14.0
RoIC (%)	9.4	13.4	14.9	16.6
Book Value (Rs)	196	221	250	283
DPS (Rs)	3.0	3.0	3.0	3.0
Dividend Payout (%)	12.0	12.0	12.0	12.0
Div Yield (%)	0.4	0.4	0.4	0.4
Asset Turnover Ratio	0.7	0.8	0.8	0.8
Avg Collection days	86	79	79	80
Avg Inventory days	110	111	110	111

Source: Company data, I-Sec research

Dr Reddy's financial summary (consolidated)

Table 5: Profit and Loss statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Global Generics	138,123	158,416	173,472	205,103
PSAI	25,747	33,156	36,471	40,119
Proprietary Products	671	0	0	0
Others	2,830	2,264	2,377	2,496
Net Sales	167,371	193,836	212,321	247,718
Total Revenue	167,371	193,836	212,321	247,718
YoY Growth%	10.1	15.8	9.5	16.7
Total Op. Exp.	132,047	146,477	159,518	174,548
EBITDA	35,324	47,359	52,803	73,169
Margins %	21.1	24.4	24.9	29.5
YoY Growth%	19.6	34.1	11.5	38.6
Depn. & Amortisation	12,472	13,057	13,404	14,182
EBIT	22,852	34,302	39,399	58,987
Other Inc/Interest (net)	2,869	2,608	2,665	2,724
Extraordinary Items	(7,690)	0	0	0
PBT	18,031	36,910	42,063	61,711
Tax	4,998	9,227	10,516	15,428
Tax Rate (%)	27.7	25.0	25.0	25.0
Minority Interest	(6,464)	-	-	-
Reported PAT	19,497	27,682	31,547	46,283
Adjusted PAT	25,055	27,682	31,547	46,283
Net Margins (%)	15.0	14.3	14.9	18.7

Source: Company data, I-Sec research

Table 6: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Paid-up Capital	831	831	831	831
Reserves & Surplus	154,157	176,837	201,667	238,095
Total Equity	154,988	177,668	202,498	238,926
Total Debt	22,102	22,102	22,102	22,102
Other non-current liab.	2,860	2,860	2,860	2,860
Capital Employed	179,950	202,630	227,460	263,888
Total Cur. Lia. & Prov.	52,016	60,137	65,743	75,368
Total Liabilities	231,966	262,767	293,202	339,256
Net Fixed Assets	83,985	101,428	100,024	97,842
Deferred tax asset	11,939	11,939	11,939	11,939
Investments	3,091	3,091	3,091	3,091
Inventory	35,066	39,947	43,756	51,051
Debtors	50,278	51,305	56,197	65,566
Other Current Assets	21,867	24,458	26,267	29,732
Cash and Equivalents	25,740	30,600	51,929	80,036
Total Cur. Assets	132,951	146,309	178,149	226,384
Total Assets	231,966	262,767	293,202	339,256

Source: Company data, I-Sec research

Table 7: Cashflow statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
PBT (Adj. for EO items)	18,031	36,910	42,063	61,711
Depreciation	12,472	13,057	13,404	14,182
Net Chg in WC	(12,357)	(3,282)	(6,876)	(14,493)
Taxes	(7,105)	(9,227)	(10,516)	(15,428)
Others	18,800	2,906	1,970	3,991
CFO	29,841	40,363	40,046	49,962
Capex	(5,725)	(30,500)	(12,000)	(12,000)
Net Investments made	(214)	-	-	-
Others	1,016	-	-	-
CFI	(4,923)	(30,500)	(12,000)	(12,000)
Change in Share capital	4	-	-	-
Change in Debts	(19,165)	-	-	-
Div. & Div Tax	(3,916)	(5,003)	(6,717)	(9,855)
Others	(2,016)	-	-	-
CFF	(25,093)	(5,003)	(6,717)	(9,855)
Total Cash Generated	(175)	4,860	21,328	28,107
Cash Opening Balance	2,228	2,053	6,913	28,242
Cash Closing Balance	2,053	6,913	28,242	56,349

Source: Company data, I-Sec research

Table 8: Key ratios

(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
Adj EPS (Rs)	112.0	166.8	190.0	278.8
YoY Growth%	9.7	48.9	14.0	46.7
Cash EPS (Rs)	187.1	245.4	270.8	364.2
EBITDA - Core (%)	21.1	24.4	24.9	29.5
NPM (%)	15.0	14.3	14.9	18.7
Net Debt to Equity (x)	(0.0)	(0.0)	(0.1)	(0.2)
P/E (x)	44.8	30.1	26.4	18.0
EV/EBITDA Core (x)	23.5	17.4	15.2	10.6
P/BV (x)	5.4	4.7	4.1	3.5
EV/Sales (x)	5.0	4.3	3.8	3.1
ROCE (%)	10.3	14.5	14.7	18.8
ROE (%)	12.6	16.6	16.6	21.0
ROIC (%)	11.9	17.0	18.1	25.7
Book Value (Rs)	933.7	1,070.3	1,219.9	1,439.3
DPS (Rs)	20.7	25.0	33.6	49.3
Dividend Payout (%)	17.7	15.0	17.7	17.7
Div Yield (%)	0.4	0.5	0.7	1.0
Asset Turnover Ratio	0.7	0.8	0.8	0.8
Avg Collection days	97	97	97	97
Avg Inventory days	75	75	75	75

Source: Company data, I-Sec research

Natco financial summary (consolidated)

Table 9: Profit & Loss statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Domestic formulations	3,552	5,328	5,328	5,861
Export formulations	5,405	4,999	5,727	6,397
APIs	9,334	10,756	11,269	20,237
Other Operating Income	859	2,445	1,039	1,143
Total Gross Sales	19,150	23,528	23,363	33,638
Excise duty	-	-	-	-
Total Net Revenue	19,150	23,528	23,363	33,638
YoY Growth%	(8.6)	22.9	(0.7)	44.0
Total Op. Exp.	13,324	16,254	15,860	17,702
EBITDA	5,826	7,273	7,503	15,935
Margins %	30.4	30.9	32.1	47.4
YoY Growth%	(26.7)	24.8	3.2	112.4
Depreciation	998	1,148	1,281	1,440
EBIT	4,828	6,125	6,222	14,495
Other Income	1,074	1,128	1,218	1,315
Interest	215	158	158	158
EO Items	0	0	0	0
PBT	5,687	7,095	7,282	15,653
Tax	1,106	1,561	1,602	3,444
Tax Rate (%)	19.4	22.0	22.0	22.0
Minority Interest	(27)	(27)	(27)	(27)
Reported PAT	4,608	5,561	5,707	12,236
Adj. PAT	4,608	5,561	5,707	12,236
Net Margins (%)	24.1	23.6	24.4	36.4

Source: Company data, I-Sec research

Table 10: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Paid-up Capital	364	364	364	364
Reserves & Surplus	37,371	41,594	45,927	55,218
Total Equity	37,735	41,958	46,291	55,582
Minority Interest	112	85	58	31
Total Debt	3,159	3,159	3,159	3,159
Deferred Liabilities	259	259	259	259
Capital Employed	41,265	45,461	49,767	59,031
Current Liabilities	4,613	6,340	5,897	7,712
Total Liabilities	45,878	51,800	55,664	66,743
Net Fixed Assets	21,024	23,876	26,595	29,156
Investments	836	836	836	836
Inventory	5,580	6,807	6,642	7,414
Debtors	5,513	6,773	6,726	9,684
Other Current Assets	12,440	13,087	13,063	14,582
Cash and Equivalents	485	421	1,802	5,072
Total Cur. Assets	24,018	27,088	28,233	36,751
Total Assets	45,878	51,800	55,664	66,743

Source: Company data, I-Sec research

Table 11: Cashflow statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
PBT (Adj. for Extraordinary)	5,687	7,095	7,282	15,653
Depreciation	998	1,148	1,281	1,440
Net Chg in WC	(410)	(1,232)	(212)	(3,020)
Taxes	(1,078)	(1,561)	(1,602)	(3,444)
Others	(1,239)	(176)	7	(414)
CFO	3,958	5,274	6,755	10,215
Capex	(3,365)	(4,000)	(4,000)	(4,000)
Net Investments made	530	-	-	-
Others	1,165	-	-	-
CFI	(1,670)	(4,000)	(4,000)	(4,000)
Change in Share capital	58	-	-	-
Change in Debts	(809)	-	-	-
Div. & Div Tax	(1,536)	(1,339)	(1,374)	(2,945)
Others	(2,136)	-	-	-
CFF	(4,423)	(1,339)	(1,374)	(2,945)
Total Cash Generated	(2,135)	(64)	1,381	3,270
Cash Opening Balance	2,795	660	596	1,977
Cash Closing Balance	660	596	1,977	5,247

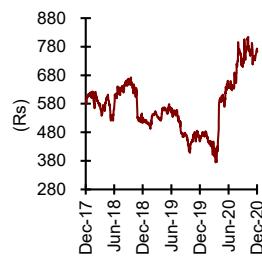
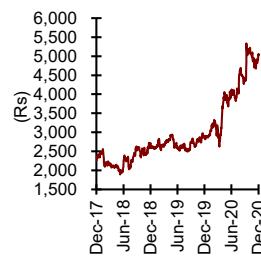
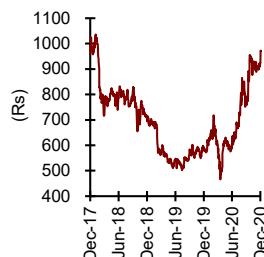
Source: Company data, I-Sec research

Table 12: Key ratios

(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
Adj EPS	25.3	30.6	31.4	67.2
YoY Growth%	(28.5)	20.7	2.6	114.4
Cash EPS	39.9	30.8	36.9	38.4
EBITDA - Core (%)	30.4	30.9	32.1	47.4
NPM (%)	24.1	23.6	24.4	36.4
Net Debt to Equity (x)	0.1	0.1	0.0	(0.0)
P/E (x)	37.6	31.1	30.3	14.1
EV/EBITDA Core (x)	28.7	23.0	22.1	10.2
P/BV (x)	4.6	4.1	3.7	3.1
EV/Sales (x)	8.7	7.1	7.1	4.8
RoCE (%)	11.7	12.8	12.0	22.2
RoE (%)	12.7	14.0	12.9	24.0
RoIC (%)	12.5	13.1	12.4	23.8
Book Value (Rs)	207	231	254	305
DPS (Rs)	5.8	6.1	6.3	13.4
Dividend Payout (%)	22.7	20.0	20.0	20.0
Div Yield (%)	0.6	0.6	0.7	1.4
Asset Turnover Ratio	0.4	0.5	0.4	0.5
Avg Collection days	101	95	105	89
Avg Inventory days	104	96	105	76

Source: Company data, I-Sec research

Price charts**Cipla****Dr Reddy's Lab****Natco Pharma**

Source: Bloomberg

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