

Q1FY22 result review
and earnings revision

Pharmaceuticals

Target price: Rs1,030

Earnings revision

(%)	FY22E	FY23E
Sales	(0.0)	(2.6)
EPS	(0.1)	(2.7)

Target price revision

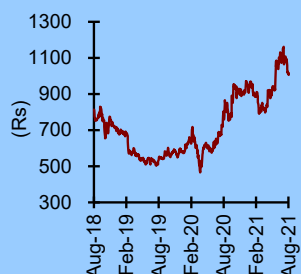
Rs1,030 from Rs1,109

Shareholding pattern

	Dec '20	Mar '21	Jun '21
Promoters	48.9	48.9	48.9
Institutional investors	33.2	32.5	29.9
MFs and others	8.9	9.5	9.0
Banks, FI's, Insurance co	0.2	6.1	6.4
FII's	18.7	16.9	14.5
Others	17.9	18.6	21.2

Source: BSE India

Price chart



Natco Pharma

HOLD
Maintained

Weak quarter; India business recovers

Rs1,041

Natco Pharma's (Natco) Q1FY22 performance was below estimates with a miss in exports and API revenues. However, India business recovered well with recovery in oncology business and upside from covid-19 related portfolio. Revenue declined 27.2% to Rs4.1bn while adjusted PAT dropped 38.9% to Rs750mn (I-Sec: Rs928mn). EBITDA margin was also down 360bps YoY to 26.8% due to lower revenue. Continued pressure on domestic oncology segment, though recovering sequentially and weak exports sales were key reasons for weak quarter. However, this doesn't change the FY22-FY23 outlook materially in terms of key product opportunities like *Revlimid*, *Nexavar*, *Everolimus*, etc. Adverse ruling in CTPR, agro-chemical product, has delayed the opportunity and we now expect material revenue from FY23E. Retain HOLD.

- **Domestic recovers, exports remain weak:** Export formulation revenue (primarily from the US) was down 47.0% due to weak flu season, competitive pressure and lack of new launches. Quarterly revenue run-rate has generally been volatile but we believe revenue should revert to ~Rs2bn in H2FY22. We expect delay in competition for generic *Copaxone* would support the US revenue run rate. RoW markets (Canada & Brazil) revenue would gradually ramp-up aided by new launches including *Revlimid*. Domestic revenue grew 59.7% YoY due to lower base and upside from covid-19 related products. The oncology business is likely to recover with pick-up in hospital occupancies and chemo-therapy treatments with increasing patient footfalls.
- **Lower revenue impacted margins, likely to recover in H2FY22E:** EBITDA margin dropped 360bps YoY to 26.8% on account of significant decline in revenue. However, with gradual pick-up in revenue and high quality product launches (*Everolimus*, *Sorafenib*, etc.) in FY22E would aid EBITDA margin reversion to ~30%. We believe base EBITDA margin would remain stable at ~30% in the near future.
- **Outlook:** We expect domestic oncology business to recover in FY22E coupled with high value launches in US which would support export sales. Favorable court ruling in agro-chem product *chlorantraniliprole* (CTPR) in Sep'21 may help in ramping-up agro chemical business. We expect 29.4% revenue and 66.6% PAT CAGR over FY21-FY23E including *Revlimid* sales in FY23E.
- **Valuations and risks:** We largely maintain our estimates and considering fair valuations, retain **HOLD** rating with a SoTP-based revised target of Rs1,030/share (earlier: Rs1,109/share) including NPV of Rs260/share for *Revlimid* and Rs77/share for *Imbruvica*. Key downside risks: Delay in US launches and early competition in *Copaxone*. Key upside risks: Swift ramp up in US launches and better than estimated revenue in the agro-chem segment.

Market Cap	Rs190bn/US\$2.6bn
Reuters/Bloomberg	NATP.BO /NTCPH IN
Shares Outstanding (mn)	182.3
52-week Range (Rs)	1162/752
Free Float (%)	51.1
FII (%)	14.5
Daily Volume (USD/'000)	8,974
Absolute Return 3m (%)	12.6
Absolute Return 12m (%)	23.4
Sensex Return 3m (%)	13.3
Sensex Return 12m (%)	44.5

Year to Mar	FY20	FY21	FY22E	FY23E
Revenue (Rs mn)	19,150	20,521	22,243	34,343
Net Income (Rs mn)	4,608	4,409	5,115	12,244
EPS (Rs)	25.3	24.2	28.0	67.1
% Chg YoY	(28.5)	(4.6)	16.0	139.4
P/E (x)	41.1	43.1	37.1	15.5
CEPS (Rs)	39.9	30.8	30.6	34.9
EV/E (x)	31.5	29.7	26.4	11.0
Dividend Yield (%)	0.6	0.6	0.5	1.3
RoCE (%)	11.7	10.3	11.0	22.5
RoE (%)	12.7	11.2	11.8	24.4

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Highlights of Q1FY22 result and earnings call

Overall sales declined 27.2% YoY to Rs4.1bn.

- **Domestic formulation business** grew 59.7% YoY and 145% QoQ to Rs2bn. The growth was primarily driven by the covid-19 related products on account of the 2nd wave. The base business also saw good growth in the quarter. *Baricitinib*, *Emphotercin B* and *Epixaban* were the key beneficiaries among the covid-19 products. Company believes that covid-19 linked portfolio would continue to witness traction in the near term. Natco has filed all the data with regards to *Molnupiravir* and are awaiting response from DCGI. 'Natco Reach' was launched during the quarter, with ~150-200 MR and sole focus on the covid-19 and diabetic portfolio. Company is planning 10-12 new launches in FY22.

Oncology segment recorded a healthy performance during the quarter amid slight competitive pressure. The company expects the upcoming pipeline of products to drive growth in the segment. The company believes the near term growth will be primarily driven by the domestic sales

International formulation business sales declined 47.0% YoY (-8.4% QoQ) to Rs1.5bn in Q1FY22.

Company witnessed a decline in *Doxil* sales due to entry of new generic. Company has received approvals for the manufacturing of *Revlimid* from Vizag and Hyderabad and expect to launch it in Mar'22. *Nexavar* will be a significant launch for the company with Natco being the sole FTF applicant. Company expects ~8-10 filings and targets ~2-3 FTFs for the financial year.

Agro-chem business is another growth segment targeted by the company. Natco has appealed the injunction order regarding *Chlorantraniliprole (CTPR)*, with hearing scheduled for Sep'21. Natco has launched a pheromone based product this quarter, which reduces pinkboll worms in cotton plantations. Company believes it will take a couple of years to fully realize the benefits from the launch.

- **API business** declined 57.2% YoY to Rs616mn.
- **Gross margin** improved 1250bps YoY (-280bps QoQ) to 80.7% due to significantly lower costs. **EBITDA margin** contracted 360bps YoY (+380bps QoQ) to 26.8%.
- **Adjusted PAT** declined 38.9% YoY to Rs750mn.

Table 1: Q1FY22 performance

(Rs mn, year ending March 31)

	Q1FY22	Q1FY21	YoY % Chg	Q4FY21	QoQ % Chg
Gross Sales	4,103	5,634	(27.2)	3,313	23.8
EBITDA	1,098	1,711	(35.8)	762	44.1
Other income	170	187	(9.1)	284	(40.1)
PBIDT	1,268	1,898	(33.2)	1,046	21.2
Depreciation	338	280	20.7	304	11.2
Interest	20	37	(45.9)	35	(42.9)
Extra ordinary income/ (exp.)	-	-	-	-	-
PBT	910	1,581	(42.4)	707	28.7
Tax	160	360	(55.6)	177	(9.6)
Minority Interest	-	(7)	-	-	-
Reported PAT	750	1,228	(38.9)	530	41.5
Adjusted PAT	750	1,228	(38.9)	530	41.5
EBITDA margins (%)	26.8	30.4	(360)bps	23.0	380bps

Source: Company data, I-Sec research

Table 2: Sales breakup

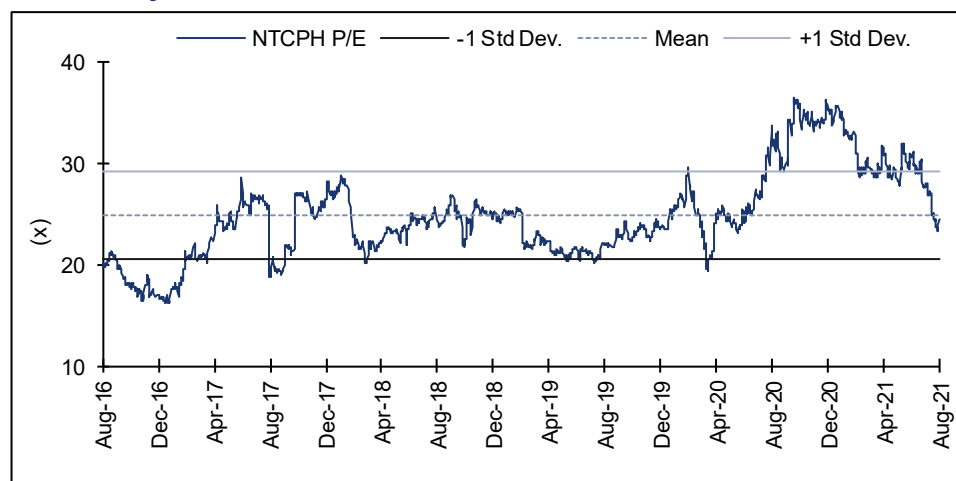
(Rs mn, year ending March 31)

	Q1FY22	Q1FY21	YoY % Chg	Q4FY21	QoQ % Chg
APIs	616	1,439	(57.2)	708	(13.0)
Formulations	3,460	3,998	(13.5)	2,406	43.8
Domestic oncology	2,006	1,256	59.7	818	145.2
Exports	1,454	2,742	(47.0)	1,588	(8.4)
Other operating income	27	184	(85.3)	199	(86.4)
Net Revenue	4,103	5,621	(27.0)	3,313	23.8

Source: Company data, I-Sec research

Valuations

The stock currently trades at valuations of 37.1x FY22E and 15.5x FY23E earnings and EV/EBITDA multiple of 26.4x FY22E and 11.0x FY23E. FY23 estimates are factoring the opportunity generic *Revlimid*. We remain positive on long-term outlook driven by its strong US pipeline including opportunities like *Revlimid*, & *Imbruvica*, recovery in domestic business in FY22E with higher patient footfalls and incremental sales from the agro-chemical business, and targeted approach in RoW markets. However, we believe the current valuations are fair and retain **HOLD** with a SoTP-based target price of Rs1,030/share (earlier: Rs1,109/share) including NPV of Rs260/share for *Revlimid* and Rs77/share for *Imbruvica*.

Chart 1: 1-year forward P/E

Source: Company data, I-Sec research

Financial summary (Consolidated)

Table 3: Profit & loss statement

(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Domestic formulations	5,405	4,102	6,153	7,076
Export formulations	9,334	9,271	11,095	20,643
APIs	3,552	5,120	4,085	4,493
Agrochemicals	-	21	200	1,350
Others	859	2,007	710	781
Total Gross Sales	19,150	20,521	22,243	34,343
Excise duty	-	-	-	-
Total Net Revenue	19,150	20,521	22,243	34,343
yoy Growth%	(8.6)	7.2	8.4	54.4
Total Op. Exp.	13,324	14,459	15,429	18,328
EBITDA	5,826	6,062	6,814	16,015
Margins %	30.4	29.5	30.6	46.6
yoy Growth%	(26.7)	4.1	12.4	135.0
Depreciation	998	1,169	1,254	1,430
EBIT	4,828	4,893	5,560	14,585
Other Income	1,074	1,036	1,140	1,254
Interest	215	133	122	122
EO Items	0	0	0	0
PBT	5,687	5,796	6,577	15,717
Tax	1,106	1,372	1,447	3,458
Tax Rate (%)	19.4	23.7	22.0	22.0
Minority Interest	(27)	15	15	15
Reported PAT	4,608	4,409	5,115	12,244
Adj. PAT	4,608	4,409	5,115	12,244
Net Margins (%)	24.1	21.5	23.0	35.7

Source: Company data, I-Sec research

Table 4: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Paid-up Capital	364	365	365	365
Reserves & Surplus	37,371	40,851	44,943	54,738
Total Equity	37,735	41,216	45,308	55,103
Minority Interest	112	18	33	48
Total Debt	3,159	2,676	2,676	2,676
Deferred Liabilities	259	413	413	413
Capital Employed	41,265	44,323	48,430	58,240
Current Liabilities	4,613	3,596	3,770	5,496
Total Liabilities	45,878	47,919	52,200	63,737
Net Fixed Assets	21,024	22,466	25,212	27,782
Investments	836	1,594	1,594	1,594
Inventory	5,580	7,982	8,517	10,118
Debtors	5,513	4,129	4,475	6,910
Other Current Assets	12,440	10,047	10,292	12,010
Cash and Equivalents	485	1,701	2,110	5,323
Total Cur. Assets	24,018	23,859	25,394	34,361
Total Assets	45,878	47,919	52,200	63,737

Source: Company data, I-Sec research

Table 5: Cashflow statement

(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
PBT (Adj. for Extraordinary)	5,687	5,796	6,577	15,717
Depreciation	998	1,169	1,254	1,430
Net Chg in WC	(410)	(2,191)	(887)	(3,567)
Taxes	(1,078)	(1,300)	(1,447)	(3,458)
Others	(1,239)	(619)	(66)	(461)
CFO	3,958	2,855	5,432	9,662
Capex	(3,365)	(2,072)	(4,000)	(4,000)
Net Investments made	530	(1,773)	-	-
Others	1,165	2,812	-	-
CFI	(1,670)	(1,033)	(4,000)	(4,000)
Change in Share capital	58	1	-	-
Change in Debts	(809)	(472)	-	-
Div. & Div Tax	(1,536)	(1,139)	(1,023)	(2,449)
Others	(2,136)	1,963	-	-
CFF	(4,423)	353	(1,023)	(2,449)
Total Cash Generated	(2,135)	2,175	409	3,213
Cash Opening Balance	2,795	660	2,835	3,244
Cash Closing Balance	660	2,835	3,244	6,457

Source: Company data, I-Sec research

Table 6: Key ratios

(Year ending March 31)

	FY20	FY21	FY22E	FY23E
Adj EPS	25.3	24.2	28.0	67.1
YoY Growth%	(28.5)	(4.6)	16.0	139.4
Cash EPS	39.9	30.8	30.6	34.9
EBITDA - Core (%)	30.4	29.5	30.6	46.6
NPM (%)	24.1	21.5	23.0	35.7
Net Debt to Equity (x)	0.1	0.0	0.0	(0.0)
P/E (x)	41.1	43.1	37.1	15.5
EV/EBITDA Core (x)	31.5	29.7	26.4	11.0
P/BV (x)	5.0	4.6	4.2	3.4
EV/Sales (x)	9.6	8.8	8.1	5.1
RoCE (%)	11.7	10.3	11.0	22.5
RoE (%)	12.7	11.2	11.8	24.4
RoIC (%)	12.5	11.0	12.1	25.5
Book Value (Rs)	207	226	248	302
DPS (Rs)	5.8	6.2	5.6	13.4
Dividend Payout (%)	22.7	25.8	20.0	20.0
Div Yield (%)	0.6	0.6	0.5	1.3
Asset Turnover Ratio	0.4	0.4	0.4	0.6
Avg Collection days	101	86	71	61
Avg Inventory days	104	121	135	99

Source: Company data, I-Sec research

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