

Natco Pharmaceuticals Ltd: Q3FY15 Result Update

Subdued Quarter

CMP: INR 1405

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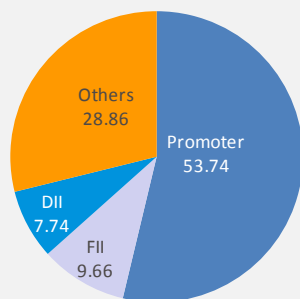
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Bloomberg: NTCPH:IN

52-week range (INR):	1,590 / 650
Share in issue (Crs):	18.85
M cap (INR crs):	4,781
Avg. Daily Vol. BSE/NSE	275
:(‘000):	

SHARE HOLDING PATTERN (%)

Date: 13th February, 2015

Natco Pharmaceuticals Ltd (NPL) reported a topline of INR 195.5 crs which was 5.8% below our estimate of INR 207.5 crs. This was mainly on account of 44% YoY de-growth witnessed in the export formulations segment led by absence of sales from the Venezuelan tender business. During the quarter, the company paid a one time settlement of INR 15.1 crs to SMS Pharma, resulting in PAT of INR 13.7 crs. Adjusting for the same, the company reported an adjusted PAT of INR 29.5 crs, lower than our estimate of INR 32.0 crs. The domestic oncology formulations segment continued to show good traction, registering a growth rate of ~28% YoY. The management has indicated for key product launches in FY 16E across various markets, which is expected to substantially boost growth momentum going forward. We believe that the company has a very impressive pipeline in the US, which is expected to contribute substantially to the company's future growth and margins. We maintain our "BUY" recommendation.

Domestic Oncology saves the day

During the quarter, NPL reported 17.8% YoY growth in the API business, while its formulations business witnessed de-growth. The drop was mainly on account of the 44% YoY reduction in export formulations due to absence of sales from the Venezuela based tender business and lack of product approvals. The domestic oncology formulations continued to show robust growth, primarily volume driven, on the back of increased traction in Vidaza and Trabectedin injection which were launched in the domestic market over the last two quarters. Other expenses declined 20.7% QoQ on account of no commission paid with respect to its Venezuelan business. Going forward, with the monetization of its pipeline, the product mix would be more skewed towards formulations than API.

Confident of monetizing pipeline

The management expects strong growth momentum in FY16E on the back of key launches expected across US, EU and India. The company expects to launch Sovaldi in India in Q1 FY16 along with gCopaxone 20mg, Budesonide and gVidaza in the US market over the course of the year. Additionally, it expects to launch Bendamustine in the EU in early 2016. NPL has also announced new filings for the US market this quarter; Cabazitaxel (\$115-120 mn), Fingolimod (\$1.2bn) and Sorafenib (\$275 mn), where the company believes it has FTF status. It has also disclosed its filing for Bosentan (\$500-600 mn), a REMS product, which it expects to launch post patent expiry in Nov 2015 conditional on FDA approval for the same. While its base business is anticipated to grow at 10-15% going forward, the upcoming launches in the regulated markets is expected to be the key trigger to boost revenues and margins going forward.

Valuations

We continue to believe that the launch of gCopaxane is a question of 'when' rather than 'if'. Also, going ahead we expect the company to head for exciting times with its launches lined up in the US, EU and India. We thus expect stable cash flows, improvement in margins and steady growth in the domestic market, and therefore maintain a "BUY" rating on the stock.

Year to March	Q3FY15	Q3FY14	% Change	Q2FY15	% Change	FY15E	FY16E	FY17E
Net Revenue (INR. Crs.)	195.5	203.4	(3.9)	219.2	(10.8)	830.9	926.7	1,017.8
EBITDA (INR Crs.)	47.6	53.9	(11.8)	58.9	(19.2)	200.9	225.8	250.0
Adj. Net Profit (INR Crs.)	29.5	29.9	(1.4)	32.4	(9.0)	126.0	148.8	170.2
Adj. Diluted EPS (INR)	8.9	9.0		9.8		38.1	45.0	51.5
Diluted P/E (x)						36.8	31.2	27.2
EV/EBITDA (x)						24.0	21.1	18.8
RoE (%)						16%	16%	16%

Q3FY15 Result Highlights

Year to March (INR Crs.)	Q3FY15	Q3FY14	%Change	Q2FY15	%Change	FY15E	FY16E	FY17E
Net Revenues	195.5	203.4	(3.9)	219.2	(10.8)	830.9	926.7	1,017.8
Raw Materials Cost	63.1	57.9	8.9	64.4	(2.1)	260.6	288.9	315.4
Gross Profit	132.4	145.5	(9.0)	154.8	(14.5)	570.3	637.8	702.5
Employee Expenses	33.3	29.8	11.9	33.7	(1.2)	141.9	158.2	173.8
Other Expenses	51.6	61.8	(16.5)	62.3	(17.2)	227.5	253.8	278.7
Operating Expenses	84.9	91.5	(7.3)	96.0	(11.6)	369.4	412.0	452.5
EBITDA	47.6	53.9	(11.8)	58.9	(19.2)	200.9	225.8	250.0
EBITDA margin	24.3%	26.5%		26.8%		24.2%	24.4%	24.6%
Depreciation	12.2	7.7	58.2	11.2	9.2	31.9	34.9	37.9
Other income	7.3	1.3	478.0	3.2	130.1	21.3	21.3	21.3
Net finance expense	8.5	9.2	(7.7)	7.2	17.5	26.5	18.7	12.1
Profit before tax	34.2	38.3	(10.6)	43.7	(21.6)	163.8	193.5	221.3
Provision for taxes	5.4	10.8	(49.9)	12.4	(56.3)	37.8	44.7	51.1
Reported net profit	28.8	27.5	4.9	31.2	(7.8)	126.0	148.8	170.2
Reported net profit	29.5	29.9		32.4				
As % of net revenues								
COGS	32.3	28.5		29.4		31.4	31.2	31.0
Employee cost	17.0	14.6		15.4		17.1	17.1	17.1
Other Expenses	26.4	30.4		28.4		27.4	27.4	27.4
Operating expenses	43.4	45.0		43.8		44.5	44.5	44.5
EBITDA	24.3	26.5		26.8		24.2	24.4	24.6
Reported net profit	14.7	13.5		14.2		15.2	16.1	16.7
Tax rate (% of PBT)	15.8	28.3		28.4		23.1	23.1	23.1

Change in Estimates

	FY15e			FY16e		
	Previous	Revised	% Change	Previous	Revised	% Change
Sales	781.6	830.9	6%	828	927	12%
EBITDA	202.7	200.9	-1%	219	226	3%
EBITDA margins	26%	24%	-2%	26%	24%	-2%
PAT	116.4	126.0	8%	130	149	14%
EPS	35.19	38.1	8%	39.40	45.0	14%

Key Takeaways from the Concall

- The company has 31 ANDA's filed for the US market, of which 9 have been commercialized
- Number of Para IV filings have doubled to 12 from 6 last year
- Domestic Oncology reported sales of 53 crs, while export formulations clocked 29 crs during the quarter
- NPL has one outstanding bill of 12 crs from Venezuela, which is covered to the extent of 80% by ECGC.
- NPL had to redo its formulation for Fosrenol along with all other filers as directed by the USFDA. The company has submitted the same to the USFDA
- The company is anticipating approval for Lansoprazole OTC in FY 16

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.

Domestic formulations make up 25% of the company's revenues, while International generics make up 16%. NPL also manufactures bulk drugs which account for 34% of its revenues (29% international and 5% domestic). The company has established an R&D centre in Hyderabad for synthetic chemistry, biotech and fermentation and also runs a chain of retail pharmacies in the US which forms 16% of its revenues.

Investment Theme

NPL is a market leader in the domestic generic oncology market, commanding a market share of 30%. Although its domestic business remains a cash cow for the company, its major growth driver is its US business where it has some very interesting niche filings which could help the company deliver extraordinary growth and 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, the company intends to launch the same on approval or market formation. We believe the pipeline for the company 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 70% 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 Crs)				
Year to March	FY13	FY14	FY15E	FY16E	FY17E
Net revenue	661	739	831	927	1,018
Materials costs	243	233	261	289	315
Gross profit	418	506	570	638	702
Employee costs	102	113	142	158	174
R & D Expenses	15	14	18	20	22
SG & A Expenses	151	199	210	234	257
EBITDA	150	179	201	226	250
Depreciation & Amortization	22	30	32	35	38
EBIT	128	149	169	191	212
Other income	18	21	21	21	21
EBIT incl. other income	146	170	190	212	233
Interest expenses	26	37	26	19	12
Profit before tax	120	134	164	194	221
Provision for tax	36	31	38	45	51
Net profit	84	103	126	149	170
Adj. Net Profit	72	103	126	149	170
Basic shares outstanding (crs)	3.31	3.31	3.31	3.31	3.31
EPS (Rs.)	25.3	31.1	38.1	45.0	51.5
Dividend per share (Rs.)	4.4	5.8	5.8	5.8	5.8
Dividend payout (%)	17.5%	18.8%	15.4%	13.0%	11.4%

Common Size

Year to March	FY13	FY14	FY15E	FY16E	FY17E
Materials costs	36.8%	31.6%	31.4%	34.8%	38.0%
Employee expenses	15.5%	15.3%	17.1%	19.0%	20.9%
Manufacturing & Other Expenses	22.8%	27.0%	25.2%	28.1%	30.9%
Research & Development Expenses	2.2%	1.9%	2.2%	2.4%	2.6%
Depreciation	3.3%	4.1%	3.8%	3.8%	3.7%
EBITDA margins	22.7%	24.3%	24.2%	24.4%	24.6%
EBIT margins	19.4%	20.2%	20.3%	20.6%	20.8%
Net profit margins	10.9%	13.9%	15.2%	16.1%	16.7%

Growth Ratios

Year to March	FY13	FY14	FY15E	FY16E	FY17E
Revenues	27.0%	11.9%	12.5%	11.5%	9.8%
EBITDA	41.0%	19.6%	12.0%	12.4%	10.7%
PBT	47.4%	11.4%	22.6%	18.1%	14.4%
Net profit	38.5%	23.0%	22.6%	18.1%	14.4%

Balance Sheet					(INR Crs)
As on 31st March	FY13	FY14	FY15E	FY16E	FY17E
Equity capital	31	33	33	33	33
Reserves & surplus	513	700	809	941	1,095
Borrowings	338	240	200	140	80
Deferred Tax Liabilities (Net)	44	43	43	43	43
Sources of funds	926	1,016	1,086	1,158	1,252
Net Fixed Assets	689	769	817	862	904
Investments	2	2	2	2	2
Inventories	146	181	184	205	225
Sundry debtors	130	119	140	156	171
Cash & Bank Balances	13	11	10	6	28
Loans and advances	101	114	121	135	148
Total current assets	389	425	455	502	573
Sundry creditors and others	145	167	175	195	214
Provisions	10	13	13	13	13
Total current liabilities & provisions	154	179	188	208	227
Net current assets	235	246	267	294	346
Uses of funds	926	1,016	1,086	1,158	1,252
Book value per share (Rs.)	161	219	253	293	339

Free cash flow					
Year to March	FY13	FY14	FY15E	FY16E	FY17E
Net profit	84	103	126	149	170
Add : Depreciation	22	30	32	35	38
Others	(1)	34	10	2	(5)
Gross cash flow	105	167	168	186	203
Less: Changes in WC	(44)	(12)	(22)	(31)	(30)
Operating cash flow	61	155	146	155	174
Less: Capex	230	111	80	80	80
Free cash flow	(169)	44	66	75	94

Cash Flow Statement					
Year to March	FY13	FY14	FY15E	FY16E	FY17E
Cash flow from operations	61	137	146	155	174
Cash Flow from investing activities	(111)	(103)	(63)	(63)	(63)
Cash Flow from financing activities	26	(35)	(83)	(95)	(89)
Capex	(230)	(111)	(80)	(80)	(80)
Dividends	(13)	(17)	(17)	(17)	(17)

Profitability & Efficiency Ratios

Year to March	FY13	FY14	FY15E	FY16E	FY17E
ROAE (%)	14.1%	16.1%	16.0%	16.4%	16.2%
ROACE (%)	17.5%	17.9%	18.4%	19.2%	19.7%
ROIC (%)	17.4%	17.5%	18.1%	18.9%	19.4%
Inventory day	71	81	81	81	81
Debtors days	62	61	61	61	61
Payable days	77	77	77	77	77
Cash conversion cycle (days)	56	65	65	65	65
Current ratio	2.5	2.4	2.4	2.4	2.5
Debt/Equity	0.6	0.3	0.2	0.1	0.1

Turnover Ratios

Year to March	FY13	FY14	FY15E	FY16E	FY17E
Total asset turnover	0.7	0.6	0.7	0.7	0.7
Fixed asset turnover	1.1	1.0	1.0	1.1	1.2
Equity turnover	1.3	1.2	1.1	1.0	1.0

Du Pont Analysis

Year to March	FY13	FY14	FY15E	FY16E	FY17E
NP margin (%)	10.9%	13.9%	15.2%	16.1%	16.7%
Total assets turnover	0.7	0.6	0.7	0.7	0.7
Leverage multiplier	2.0	1.8	1.6	1.5	1.4
ROAE (%)	14.1%	16.1%	16.0%	16.4%	16.2%

Valuation Parameters

Year to March	FY13	FY14	FY15E	FY16E	FY17E
Diluted EPS (Rs.)	25.3	31.1	38.1	45.0	51.5
Y-o-Y growth (%)	38.5%	23.0%	22.6%	18.1%	14.4%
Diluted PE (x)	55.5	45.1	36.8	31.2	27.2
Price/BV (x)	8.7	6.4	5.6	4.8	4.1
EV/Sales (x)	7.4	6.5	5.8	5.1	4.6
EV/EBITDA (x)	33.1	27.1	24.0	21.1	18.8
Dividend yield (%)	0.3%	0.4%	0.4%	0.4%	0.4%

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