

CMP : Rs 635

Rating : Buy

Target :Rs 774

STOCK INFO

| | |
|--------------------------|-----------------|
| INDEX | |
| BSE | 524816 |
| NSE | NATCOPHARM |
| Bloomberg | NTCPH IN |
| Reuters | NATP.BO |
| Sector | Pharmaceuticals |
| Face Value (Rs) | 2 |
| Equity Capital (Rsmn) | 369 |
| Mkt Cap (Rsmn) | 116940 |
| 52w H/L (Rs) | 848/ 633 |
| Avg Weekly Vol (BSE+NSE) | 230,628 |

SHAREHOLDING PATTERN

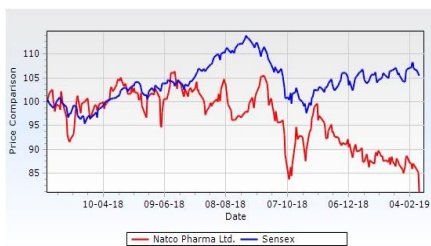
| | |
|-------------------|----------|
| | % |
| (as on Dec, 2018) | |
| Promoters | 48.3 |
| Public & Others | 51.7 |

Source: ACE Equity, Arihant Research

| | | | |
|-----------------------------|-----------|-----------|------------|
| STOCK PERFORMANCE(%) | 3m | 6m | 12m |
| Natco | -14.0 | -15.0 | -19.0 |
| SENSEX | 3.8 | -4.0 | 5.8 |

Source: ACE Equity, Arihant Research

Natco v/s SENSEX



Source: ACE Equity, Arihant Research

Natco Pharma reported a 27% drop in profit in Q3 FY19. Profitability was reduced due to margin reduction in few products. Tamiflu sales were disappointing for the quarter. Management expects further reduction in Tamiflu. Profitability to be driven by capoxone going ahead. Tamiflu share to decrease substantially as the flu season has ended. Loss in Tamiflu is expected to offset from ramp up in capoxone.

Agro Chemical investments to fuel the topline in 2-3 years

In Agro Chemical space, Natco has identified some niche molecules. Natco has always invested in molecules with very limited competition and this strategy is applied even in the agro chemicals space. Management doesn't expect much competition from the big players like UPL and PI. Company will be investing Rs 100 crores in the Agro Chemical segment and expects to commercialise in 2-3 years. As these products are niche, expect immediate spurt in the sales after the launch. Management aims Agro Chemicals to contribute 10-15% of the total revenue.

China Approvals in 2-3 Years

Natco is targeting the China market where approvals are on a fast track for the companies having presence in the western countries. Chinese market is so large that an approval in China will boost the revenue like a drug launch in USA. Company has file couple of products and expects approvals in 2-3 years.

US launches in pipeline

Revlimid with the market size of approx \$4000 mn is expected to launch at the end of 2019 if everything is on track. This will be a huge opportunity for Natco Pharma. Management expects few more launches in US but no big launches as of now. Management expects big launches between FY22-24.

Focus on ROW

Focus will be on Brazil, Canada and few other countries with more aggressive launches. Company plans to file 8-10 products with a market size of \$7 - \$8million. These products will drive the profitability for the company, as they are high margin products.

India business to see aggressive launches

Company will be focusing on the India business with 8-10 launches in Oncology, Speciality pharma and Cardiology & Diabetology segment. These launches will be the potential growth drivers for the company.

Other Highlights

R&D expense will be around 8.5-9% of the revenue.
Capex of Rs 350-400 crore to be maintain going forward.

Outlook and valuation

Approvals for the products will be the key going ahead. We are bullish on the future prospects of the company. **At CMP of Rs 635 Natco trades at PE of 18x and 15x of FY19E and FY20E earnings respectively. We retain our Buy rating on the stock with a target price of Rs 774 valuing Natco at 18x to our FY20E EPS.**

Financial Snapshot

| Yr (Rs mn) | Net Sales | EBITDA | PAT | EPS | EBITDA Margins | ROE (%) | P/E (x) |
|------------|-----------|--------|------|-----|----------------|---------|---------|
| FY16 | 11413 | 2726 | 1558 | 9 | 24% | 15% | 74 |
| FY17 | 20202 | 6834 | 4849 | 27 | 34% | 33% | 24 |
| FY18 | 21848 | 9284 | 6952 | 38 | 42% | 29% | 17 |
| FY19E | 23499 | 8225 | 6532 | 36 | 35% | 21% | 18 |
| FY20E | 27314 | 10106 | 7879 | 43 | 37% | 23% | 15 |

Quarterly Update

| Particulars Rs Mn | Q3 FY19 | Q2FY19 | Q3FY18 | YoY | QoQ |
|-----------------------|---------|--------|--------|------|-------|
| Sales | 5567 | 5435 | 5622 | -1% | 2% |
| Other Income | 233 | 400 | 114 | 104% | -42% |
| Total Income | 5800 | 5835 | 5736 | 1% | -1% |
| Expenses | | | | | |
| Cost Of Material | 1173 | 843 | 822 | 43% | 39% |
| Changes in Inventory | -123 | 106 | -164 | -25% | -216% |
| Employee Benefit | 933 | 926 | 788 | 18% | 1% |
| Other Expense | 1500 | 1355 | 1311 | 14% | 11% |
| Total | 3483 | 3230 | 2757 | 26% | 8% |
| EBITDA | 2084 | 2205 | 2865 | -27% | -5% |
| EBITDA Margins | 37% | 41% | 51% | | |
| Depreciation | 207 | 202 | 172 | 20% | 2% |
| EBIT | 1877 | 2003 | 2693 | -30% | -6% |
| EBIT Margins | 34% | 37% | 48% | | |
| Finance | 63 | 50 | 43 | 47% | 26% |
| PBT | 2047 | 2353 | 2764 | -26% | -13% |
| Total Tax | 454 | 537 | 590 | -23% | -15% |
| Effective Tax Rate | 22% | 23% | 21% | | |
| PAT | 1593 | 1816 | 2174 | -27% | -12% |
| EPS | 8.7 | 10 | 11.94 | -27% | -12% |

P&L Consolidated

| Rs in Mn | FY16 | FY17 | FY18 | FY19E | FY20E |
|------------------------------|-------|-------|-------|-------|-------|
| Revenue | 11413 | 20202 | 21848 | 23499 | 27314 |
| Cost of materials | 3411 | 5991 | 4111 | 5405 | 5736 |
| Gross Profit | 8002 | 14211 | 17737 | 18094 | 21578 |
| Gross Margins | 70% | 70% | 81% | 77% | 79% |
| Operation and other expenses | 5276 | 7377 | 8453 | 9869 | 11472 |
| Total Operating Expenses | 8687 | 13368 | 12564 | 15274 | 17208 |
| EBIDTA | 2726 | 6834 | 9284 | 8225 | 10106 |
| EBIDTA Margin | 24% | 34% | 42% | 35% | 37% |
| Depreciation | 510 | 544 | 662 | 822 | 910 |
| EBIT | 2216 | 6290 | 8622 | 7402 | 9196 |
| Interest | 229 | 185 | 154 | 193 | 229 |
| Other Income | 99 | 139 | 404 | 1274 | 1266 |
| PBT | 2086 | 6244 | 8872 | 8483 | 10233 |
| Tax | 528 | 1395 | 1920 | 1951 | 2354 |
| PAT | 1558 | 4849 | 6952 | 6532 | 7879 |
| Growth (%) | 20% | 20% | 20% | -6% | 21% |
| EPS | 9 | 27 | 38 | 36 | 43 |

Balance Sheet Consolidated

| Rs Mn | FY16 | FY17 | FY18 | FY19E | FY20E |
|-------------------------------|-------|-------|-------|-------|-------|
| Shareholder's funds | | | | | |
| Share Capital | 348 | 349 | 369 | 364 | 364 |
| Reserves & Surplus | 12609 | 16144 | 30353 | 32581 | 33832 |
| Net Worth | 13006 | 16534 | 30760 | 32985 | 34237 |
| Total Non Current Liabilities | 280 | 377 | 471 | 475 | 475 |
| Borrowings | 984 | 2216 | 1732 | 2131 | 2534 |
| Trade Payables | 2756 | 2627 | 2691 | 3090 | 3592 |
| Total Current Liabilities | 4931 | 6265 | 5920 | 6718 | 7623 |
| Total Liabilities | 18217 | 23176 | 37151 | 40179 | 42334 |
| Net Block | 7046 | 8272 | 10127 | 11749 | 13007 |
| Capital Work-in-Progress | 2118 | 3363 | 4800 | 5522 | 6113 |
| Total Non Current Assets | 9847 | 12303 | 15844 | 18396 | 20164 |
| Receivables | 2616 | 4752 | 6375 | 5923 | 6885 |
| Cash and bank balance | 242 | 235 | 217 | 653 | 1906 |
| Total Current Assets | 8370 | 10873 | 21307 | 21783 | 22171 |
| Total Assets | 18217 | 23176 | 37151 | 40179 | 42334 |

Cash Flow Consolidated

| Rs Mn | FY16 | FY17 | FY18 | FY19E | FY20E |
|--|-------|-------|-------|-------|-------|
| Profit Before taxes | 2015 | 6244 | 8872 | 8483 | 10233 |
| Add:- Depreciation | 510 | 544 | 662 | 822 | 910 |
| Cash generated from operations | 1584 | 4716 | 6681 | 7159 | 10824 |
| Taxes paid | -462 | -1258 | -2045 | -1951 | -2354 |
| Net cash flow from operating activities | 1122 | 3458 | 4636 | 5207 | 8470 |
| FCFF | -452 | 666 | 411 | 1207 | 3970 |
| Purchase of fixed assets | -1574 | -2792 | -4225 | -4000 | -4500 |
| Others | -181 | -202 | -6930 | 1182 | -448 |
| Net cash flow from investing activities | -1755 | -2994 | 11155 | -2818 | -4948 |
| Dividend paid | -261 | -1409 | -1814 | -1548 | -1639 |
| Other | 1801 | 932 | 8323 | -405 | -414 |
| Net cash used in financing activities | 1540 | -477 | 6509 | -1953 | -2053 |
| Net Cash Flow | 899 | -7 | -18 | 436 | 1469 |
| Opening Cash balance | -1642 | 242 | 235 | 217 | 436 |
| Closing Cash balance | 242 | 235 | 217 | 653 | 1906 |

Key Ratio

| Particulars | FY16 | FY17 | FY18 | FY19E | FY20E |
|---------------------------|------|------|------|-------|-------|
| EPS (Rs) | 9 | 27 | 38 | 36 | 43 |
| Book Value Per Share (Rs) | 71 | 91 | 169 | 181 | 188 |
| P/E (x) | 74 | 24 | 17 | 18 | 15 |
| EBIDTA Margin | 24% | 34% | 42% | 35% | 37% |
| PBT Margin | 18% | 31% | 41% | 36% | 37% |
| PAT Margin | 14% | 24% | 32% | 28% | 29% |
| Debt/Equity (x) | 0.09 | 0.14 | 0.06 | 0.06 | 0.07 |
| Current Ratio (x) | 1.70 | 1.74 | 3.60 | 3.24 | 2.91 |
| ROE | 15% | 33% | 29% | 21% | 23% |

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Stock Rating Scale

| | Absolute Retu |
|------------|---------------|
| BUY | >20% |
| ACCUMULATE | 12% to 20% |
| HOLD | 5% to 12% |
| NEUTRAL | -5% to 5% |
| REDUCE | <-5% |

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