

## NATCO PHARMA

PHARMACEUTICALS

# BUY

Target Price: Rs 1,240

### Catapulted by gCopaxone; Reiterate BUY

Natco's (partner Mylan) 1<sup>st</sup> generic approval for gCopaxone 40mg (USD 2.9 bn market; possibility of 180 day exclusivity) and 2<sup>nd</sup> generic approval for gCopaxone 20mg (USD 700 mn market) demonstrate its R&D ability to execute on complex generics with intricate chemistry and complex processes (also demonstrated by 2<sup>nd</sup> generic approval for gDoxil Liposomal injection in May'17).

In our recent note **gCopaxone – Delayed, not Derailed**, we had assumed 20mg/40mg launch in Apr'18/ Oct'18. With earlier than anticipated approvals, we now build in immediate launch for 20mg; expect 40mg launch in end-CY17 (given on-going litigation). Our base case scenario analysis suggests 20 mg sales of ~USD 20 mn in H2FY18/USD 32 mn in FY19 and 40mg sales of ~USD 32 mn in Q4FY18/ USD 107 mn in FY19. Raise FY18/19 EPS est. by 56%/37% with revised **SOTP of Rs 1,240** (20x FY19E EPS + Rs 117 for R&D pipeline). Maintain **BUY**.

CMP : Rs 954  
Potential Upside : 30%

#### MARKET DATA

No. of Shares : 174mn  
Free Float : 49%  
Market Cap : Rs 166bn  
52-week High / Low : Rs 1,080 / Rs 495  
Avg. Daily vol. (6mth) : 453,147 shares  
Bloomberg Code : NTCPH IB Equity  
Promoters Holding : 51%  
FII / DII : 22% / 5%

- ◆ **Natco ahead of the pack on gCopaxone 40mg:** While Momenta (partner Sandoz) received approval (and launched) for gCopaxone 20-mg in Apr 2015 (~40% market share), we note it has not received approval for gCopaxone 40-mg (as its contracted fill/finish facility received USFDA warning letter in Feb'17). Dr Reddy's has TAD@ for gCopaxone 20mg in Nov'17, but has outstanding CRL^ for gCopaxone 40mg (expected to submit a response to the USFDA in the near term, as per its last earnings call). Biocon also has a CRL for its gCopaxone filing, and expects to submit a detailed response letter to the USFDA by end-FY18. Amneal, Synthron are other filers
- ◆ **Risk-return seems favorable for Natco/ Mylan:** While Mylan can immediately launch gCopaxone 20 mg (no patent protection, Momenta (partner Sandoz) is already present in the market), we expect it to launch gCopaxone 40 mg at risk by Dec'17 given favorable risk-return as 3 orange book listed patents for Copaxone 40mg have been invalidated by the US PTAB (Patent Trial and Appeal Board), while 4 orange book listed patents have been invalidated by the US district court. The Court of Appeals ruling on Teva's appeal of the District Court's decision to invalidate 4 orange book patents of Copaxone 40mg is expected in late CY2017 or early CY2018

#### Financial summary (Consolidated)

Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs mn)	10,801	20,650	22,411	30,444
Adj PAT (Rs mn)	1,549	4,860	6,104	9,796
Con. EPS* (Rs)	-	-	26.5	35.3
EPS (Rs)	8.9	27.9	35.0	56.1
Change YOY (%)	(9.2)	213.2	25.6	60.5
P/E (x)	107.3	34.3	27.3	17.0
RoE (%)	14.5	33.0	31.9	37.3
RoCE (%)	17.3	38.9	35.8	43.2
EV/E (x)	62.8	24.6	20.1	12.6
DPS (Rs)	1.2	3.0	4.0	4.0

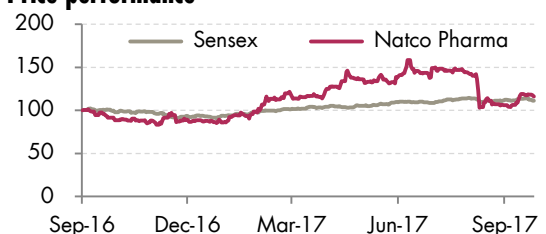
Source: \*Consensus broker estimates, Company, Axis Capital

@TAD – Target Action Date ^CRL – Complete response letter

#### Key drivers

Growth (%)	FY17	FY18E	FY19E
US (USD mn)	125	130	207
US growth (%)	368	4	59
India (%)	33	14	20
EBITDA margin (%)	33.1	37.0	42.5

#### Price performance



- ◆ **Scenario Analysis:** While our revised base case TP of Rs 1,240 implies 30% upside (Rs 940 earlier); our scenario analysis suggests bull case TP of Rs 1,643 (2 generic player market for Copaxone 40 mg in FY19) and bear case TP of Rs 991 (5 generic payer market for Copaxone 40 mg).

**Exhibit 1: Scenario analysis**

	Earlier	Scenario analysis (FY19 EPS)		
EPS (ex-Copaxone)	27	24	24	24
<b>Copaxone -20mg</b>				
Sales (USD mn)	22	32	32	32
EPS	5	7	7	7
<b>Copaxone -40mg</b>		<b>Bull Case</b>	<b>Base Case</b>	<b>Bear Case</b>
No of generics		2	3	5
Sales (USD mn)	44	172	107	61
EPS	9	45	25	13
Total EPS	41	76	56	44
P/E multiple	20	20	20	20
Business value	822	1,527	1,123	875
R&D Value (gRevlimid, gNexavar)	119	117	117	117
<b>Target Price</b>	<b>940</b>	<b>1,643</b>	<b>1,240</b>	<b>991</b>

Source: Axis Capital

**Exhibit 2: Copaxone (40 mg): Orange book Patent Data**

Patent No	Patent Expiration	Comments
8232250	19-Aug-30	Invalidated by PTAB (Aug 2016) and US district Court (Jan 2017)
8399413	19-Aug-30	
8969302	19-Aug-30	Invalidated by PTAB (Sep 2016) and US district Court (Jan 2017)
9155776	19-Aug-30	Invalidated US district Court (Jan 2017)
9402874	19-Aug-30	Issued on Aug 02, 2016

Source: Company, Axis Capital

**Exhibit 3: US scale-up to continue to be driven by complex generics**

Brand name	Market size (USD mn)	Expected launch date	USD mn			
			FY16	FY17	FY18	FY19
Copaxone 20 mg	700	Oct-17	-	-	20	32
Copaxone 40mg	2,840	Jan-18	-	-	32	107
Tamiflu	500	Dec-16	-	96	9	5
Tamiflu suspension	213	Oct-17	-	-	8	4
Doxil (liposome inj)	196	May-17	-	-	14	14
Fosrenol	120	Sep-17	-	-	9	5
Entocort	370	Nov-16	-	3	5	3
Nuvigil	470	Dec-16	-	2	4	1
Vidaza	203	H2FY18	-	-	6	9
Gleevec	2,000	FY19	-	-	-	4
Tracleer	368	FY19	-	-	-	3
<b>New product revenue</b>			-	101	108	186
Base US Revenue			27	24	22	21
<b>Total US revenues</b>			<b>27</b>	<b>125</b>	<b>130</b>	<b>207</b>

Source: Company, Axis Capital

**Financial summary (Consolidated)**
**Profit & loss (Rs mn)**

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	10,801	20,650	22,411	30,444
Other operating income	-	-	-	-
<b>Total operating income</b>	<b>10,801</b>	<b>20,650</b>	<b>22,411</b>	<b>30,444</b>
Cost of goods sold	(2,706)	(5,991)	(5,939)	(8,144)
Gross profit	8,095	14,659	16,472	22,300
<i>Gross margin (%)</i>	<i>74.9</i>	<i>71.0</i>	<i>73.5</i>	<i>73.3</i>
Total operating expenses	(5,439)	(7,825)	(8,170)	(9,368)
<b>EBITDA</b>	<b>2,656</b>	<b>6,834</b>	<b>8,302</b>	<b>12,932</b>
<i>EBITDA margin (%)</i>	<i>24.6</i>	<i>33.1</i>	<i>37.0</i>	<i>42.5</i>
Depreciation	(508)	(544)	(657)	(796)
<b>EBIT</b>	<b>2,148</b>	<b>6,290</b>	<b>7,645</b>	<b>12,136</b>
Net interest	(229)	(185)	(129)	(84)
Other income	96	139	242	409
<b>Profit before tax</b>	<b>2,015</b>	<b>6,244</b>	<b>7,758</b>	<b>12,461</b>
Total taxation	(479)	(1,395)	(1,668)	(2,679)
<i>Tax rate (%)</i>	<i>23.8</i>	<i>22.3</i>	<i>21.5</i>	<i>21.5</i>
Profit after tax	1,536	4,849	6,090	9,782
Minorities	13	11	13	13
Profit/ Loss associate co(s)	-	-	-	-
<b>Adjusted net profit</b>	<b>1,549</b>	<b>4,860</b>	<b>6,104</b>	<b>9,796</b>
<i>Adj. PAT margin (%)</i>	<i>14.3</i>	<i>23.5</i>	<i>27.2</i>	<i>32.2</i>
Net non-recurring items	22	-	-	-
<b>Reported net profit</b>	<b>1,571</b>	<b>4,860</b>	<b>6,104</b>	<b>9,796</b>

**Balance sheet (Rs mn)**

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	348	349	349	349
Reserves & surplus	12,609	16,144	21,410	30,368
Net worth	12,957	16,493	21,759	30,717
Borrowing	984	2,216	3,213	2,089
Other non-current liabilities	147	150	150	150
<b>Total liabilities</b>	<b>14,137</b>	<b>18,900</b>	<b>25,150</b>	<b>32,970</b>
Gross fixed assets	9,836	11,609	15,870	18,370
Less: Depreciation	(2,735)	(3,279)	(3,936)	(4,732)
Net fixed assets	7,101	8,330	11,934	13,638
Add: Capital WIP	2,118	3,363	3,363	3,363
Total fixed assets	9,219	11,693	15,297	17,001
Total Investment	222	322	1,072	2,572
Inventory	3,573	3,489	3,905	5,132
Debtors	2,616	4,752	5,157	7,006
Cash & bank	452	358	1,331	3,484
Loans & advances	28	35	38	52
Current liabilities	4,080	4,276	4,394	6,002
Net current assets	4,696	6,885	8,780	13,397
Other non-current assets	-	-	-	-
<b>Total assets</b>	<b>14,137</b>	<b>18,900</b>	<b>25,150</b>	<b>32,970</b>

Source: Company, Axis Capital

**Cash flow (Rs mn)**

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	2,015	6,244	7,758	12,461
Depreciation & Amortisation	508	544	657	796
<i>Chg in working capital</i>	<i>(1,407)</i>	<i>(2,528)</i>	<i>(922)</i>	<i>(2,464)</i>
<b>Cash flow from operations</b>	<b>1,122</b>	<b>3,458</b>	<b>5,712</b>	<b>7,789</b>
<i>Capital expenditure</i>	<i>(1,574)</i>	<i>(2,792)</i>	<i>(3,500)</i>	<i>(2,500)</i>
<b>Cash flow from investing</b>	<b>(1,755)</b>	<b>(2,994)</b>	<b>(4,250)</b>	<b>(4,000)</b>
<i>Equity raised/ (repaid)</i>	<i>3,344</i>	-	-	-
<i>Debt raised/ (repaid)</i>	<i>(1,291)</i>	<i>(142)</i>	<i>997</i>	<i>(1,125)</i>
<i>Dividend paid</i>	<i>(261)</i>	<i>(1,409)</i>	<i>(838)</i>	<i>(838)</i>
<b>Cash flow from financing</b>	<b>1,540</b>	<b>(1,709)</b>	<b>31</b>	<b>(2,046)</b>
Net chg in cash	907	(1,245)	1,493	1,743

**Key ratios**

Y/E March	FY16	FY17	FY18E	FY19E
<b>OPERATIONAL</b>				
FDEPS (Rs)	8.9	27.9	35.0	56.1
CEPS (Rs)	11.9	31.0	38.7	60.7
DPS (Rs)	1.2	3.0	4.0	4.0
Dividend payout ratio (%)	13.9	10.8	11.4	7.1
<b>GROWTH</b>				
Net sales (%)	28.8	91.2	8.5	35.8
EBITDA (%)	17.3	157.3	21.5	55.8
Adj net profit (%)	(4.9)	213.7	25.6	60.5
FDEPS (%)	(9.2)	213.2	25.6	60.5
<b>PERFORMANCE</b>				
RoE (%)	14.5	33.0	31.9	37.3
RoCE (%)	17.3	38.9	35.8	43.2
<b>EFFICIENCY</b>				
Asset turnover (x)	0.9	1.3	1.1	1.2
Sales/ total assets (x)	0.7	1.0	0.9	0.9
Working capital/ sales (x)	0.3	0.3	0.3	0.3
Receivable days	88.4	84.0	84.0	84.0
Inventory days	160.1	92.2	101.0	107.0
Payable days	123.5	69.4	67.4	74.4
<b>FINANCIAL STABILITY</b>				
Total debt/ equity (x)	0.1	0.2	0.2	0.1
Net debt/ equity (x)	-	0.1	-	(0.2)
Current ratio (x)	2.2	2.6	3.0	3.2
Interest cover (x)	9.4	34.0	59.5	145.3
<b>VALUATION</b>				
PE (x)	107.3	34.3	27.3	17.0
EV/ EBITDA (x)	62.8	24.6	20.1	12.6
EV/ Net sales (x)	15.4	8.1	7.5	5.3
PB (x)	12.8	10.1	7.7	5.4
Dividend yield (%)	0.1	0.3	0.4	0.4
Free cash flow yield (%)	-	-	-	-

Source: Company, Axis Capital

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