Neuland Labs

BUY

INDUSTRY	PHARMA
CMP *(as on 11 May 2018)*	**Rs 787**
Target Price	**Rs 1,000**
Nifty	10,807
Sensex	35,536
KEY STOCK DATA	
Bloomberg	NLL IN
No. of Shares (mn)	16
MCap (Rs bn) / ($ mn)	12/184
6m avg traded value (Rs mn)	26

STOCK PERFORMANCE (%)

52 Week high / low	Rs 1,548/668		
	3M	6M	12M
Absolute (%)	13.0	(32.7)	(41.7)
Relative (%)	8.5	(39.4)	(59.2)

SHAREHOLDING PATTERN (%)

Promoters	51.7
FIs & Local MFs	6.3
FPIs	6.4
Public & Others	22.7

Source : BSE

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Getting it right

Ahead of expectations, Neuland Labs (NLL) ended the year with improved business performance. Top line grew 13.2% YoY/31.5% QoQ to Rs 1.6bn, with significant jump seen in Ciprofloxacin and Levetiracetam revenues during this quarter. EBITDA declined 34%YoY to Rs 188mn. However, sequential growth of 105% was encouraging. EBITDA margin stood at 11.7% (down 838bps YoY, up 420bps QoQ and 170bps ahead of expectation). Reported PAT after merging with NHSPL and NPRPL, came in at Rs 81mn in 4QFY18.

With washout FY18 nearly over, NLL is likely to report a strong recovery in FY19. This will largely be driven by returning volumes in the Niche API and CMS business segments, with all eyes on the launch of gAdvair in the US. Foresee 19% revenue CAGR, 820bps margin expansion and 5.5x earnings over FY18-20E (favorable base). At peak demand, API supply for Salmeterol, Deutetrabenazine and Trulance are likely to add Rs 43, Rs 18 and Rs 20 EPS respectively. Re-iterate BUY with a TP of Rs 1,000 (16x on FY20E EPS).

- **Segment-wise performance:** The largest business segment, prime API, reported significant uptick in revenues with 57%YoY growth. This was largely driven by higher off-take in Ciprofloxacin, Levetiracetam and Sotalol APIs. However, other two segments, Niche API and CMS, declined 6% and 12% YoY respectively. Sequentially, both the segments reported positive growth (Niche APi: 6%, CMS: 12%) during this quarter. Lack of Salmeterol orders was the major reason for the fall in Niche API segment revenues. Similarly, CMS segment witnessed lower off take in Anti-histamine product.
- **gAdavair launch in the US :** The first gAdvair launch is expected in the US on 27th June'18. It will be the primary driver for Salmeterol API sales to pick up in FY19/20E, along with the requirement of API supplies for clinical trials in the US market (Lupin, Amneal etc). The management also highlighted that there is growing demand for Dorzolamide, Brinzolamide and Paliperidone APIs and NLL is likely to see good ramp up in FY19 in these supplies as well.

Highlights of the quarter

- **Takeaways:** (1) Capex guidance at Rs 500-1bn in FY19, (2) Effective tax rate to be at 20-22% in FY19. (3) Increased raw material prices led to lower gross margin during this quarter. (4) Filed 4 DMFs in 4QFY18.

Financial Summary

Year Ending March (Rs mn)	4QFY18	4QFY17	*YoY (%)*	3QFY18	*QoQ (%)*	FY17	FY18E	FY19E	FY20E
Net Sales	1,602	1,415	*13.2*	1,219	*31.5*	5,789	5,274	6,041	7,459
EBITDA	188	285	*(34.0)*	92	*104.9*	1,063	504	822	1,328
APAT	81	158	*(49.0)*	7	*993.9*	469	121	317	685
Diluted EPS (Rs)	7.3	14.4	*(49.0)*	0.7	*993.9*	42.6	11.0	28.9	62.3
EV/EBITDA (x)						9.7	22.7	13.3	8.0
RoE (%)						12.8	2.2	5.5	11.1

Source: Company, HDFC sec Inst Research

Net revenues grew 13%YoY to Rs 1.6bn, driven by prime API segment

Gross margin was lower due to increased raw material prices

EBITDA margin showed sequential improvement, YoY decline was largely on account of unfavorable business mix and increased costs

Quarterly Financials Snapshot (Consolidated)

Particulars	4QFY18	4QFY17	YoY (%)	3QFY18	QoQ (%)
Net Sales	**1,602**	**1,415**	***13.2***	**1,219**	***31.5***
Material Expenses	803	512	*56.6*	540	*48.5*
Employee Expenses	225	246	*(8.5)*	248	*(9.2)*
Other Expenses	387	373	*3.8*	339	*14.2*
EBITDA	**188**	**285**	***(34.0)***	**92**	***104.9***
Depreciation	56	51		57	
EBIT	**132**	**234**	***(43.6)***	**35**	***279.5***
Other Income	3	1		13	
Interest Cost	49	49		46	
PBT	**86**	**187**	***(54.0)***	**2**	***4,504.8***
Tax	5	40		(5)	
Minority Interest	-	(11)		-	
RPAT	**81**	**158**	***(49.0)***	**7**	***993.9***
EO Items (Adj For Tax)					
APAT	**81**	**158**	***(49.0)***	**7**	***993.9***

Source: Company, HDFC sec Inst Research

Margin Analysis

	4QFY18	4QFY17	YoY (bps)	3QFY18	QoQ (bps)
Material Expenses % Net Sales	50.1	36.2	*1,389*	44.3	*575*
SG&A Expenses % Net Sales	14.0	17.4	*(332)*	20.3	*(629)*
Other Expenses % Net Sales	24.1	26.3	*(219)*	27.8	*(366)*
EBITDA Margin (%)	11.7	20.1	*(838)*	7.5	*420*
Tax Rate (%)	6.3	21.3	*(1,507)*	(294.5)	*30,081*
APAT Margin (%)	5.0	11.2	*(613)*	0.6	*442*

Source: Company, HDFC sec Inst Research

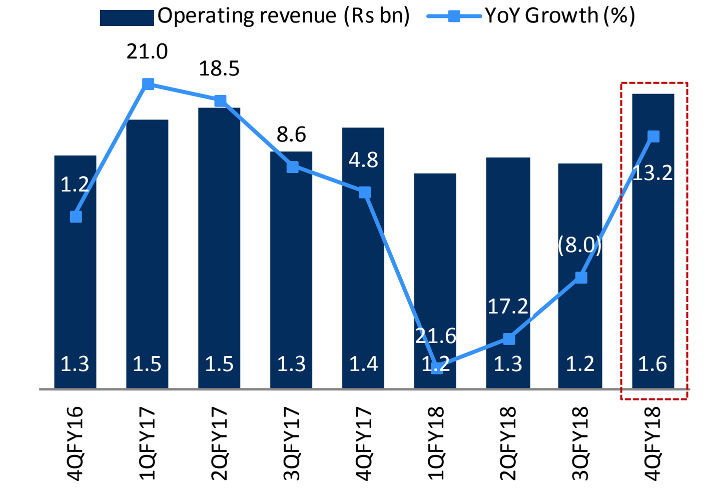
NLL have reported positive top line growth after three quarters

Highest EBITDA in last four quarters, recovery likely to continue in coming quarters

Driven by higher Ciprofloxacin orders, Prime API segment grew 57%YoY in 4QFY18

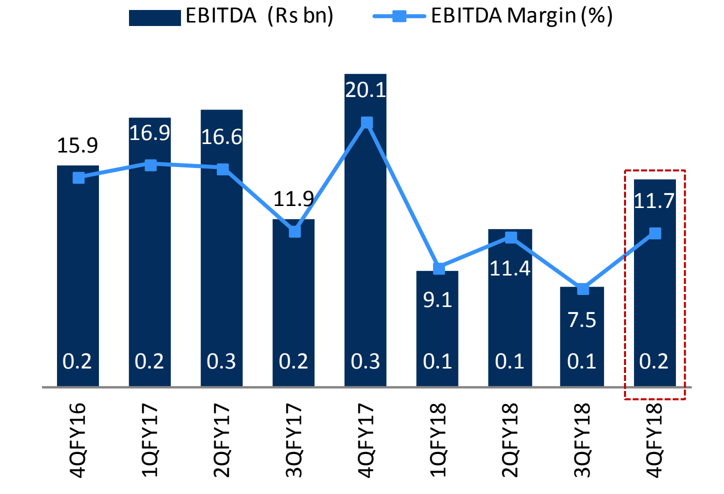
CMS continues to be lumpy and declined ~13%YoY

Revenue: Delivered 13%YoY Growth



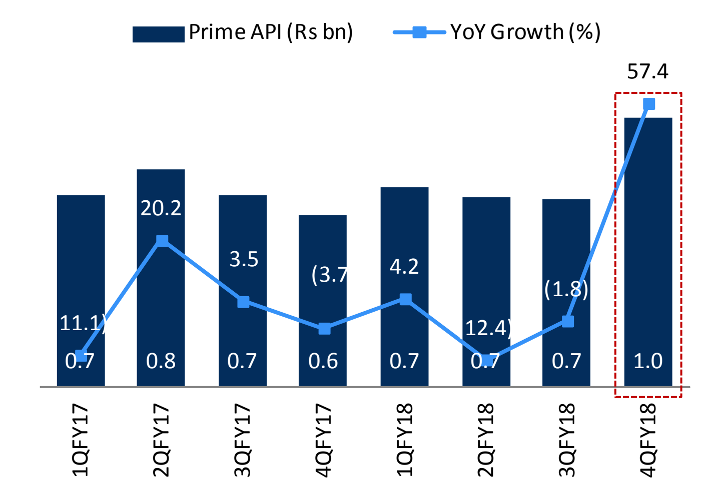
Source: Company, HDFC sec Inst Research

EBITDA Margin Improved To 11.7%



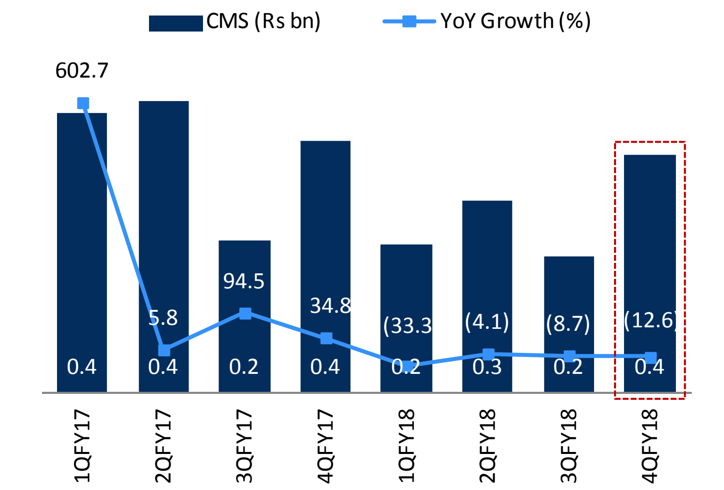
Source: Company, HDFC sec Inst Research

Prime API Segment Jumped 57%YoY



Source: Company, HDFC sec Inst Research

CMS Revenue Recovered Sequentially



Source: Company, HDFC sec Inst Research

Segmental Quarterly Performance

(Rs mn)	4QFY18	4QFY17	YoY (%)	3QFY18	QoQ (%)
Prime API	981	623	*57.4*	682	*43.7*
Niche API	359	382	*(6.1)*	207	*73.2*
CMS	359	410	*(12.6)*	329	*9.1*
Total	**1,698**	**1,415**	***20.0***	**1,219**	***39.4***

Source: HDFC sec Inst Research

Assumptions

	FY16	FY17	FY18	FY19E	FY20E
Prime API	2,907	2,806	3,084	3,106	3,313
Growth (%)	*(4.7)*	*(3.5)*	*9.9*	*0.7*	*6.7*
Niche API	1,377	1,477	1,079	1,470	1,720
Growth (%)	*33.4*	*7.2*	*(26.9)*	*36.3*	*17.0*
CMS	867	1,394	1,188	1,485	2,450
Growth (%)	*42.1*	*60.8*	*(14.8)*	*25.0*	*65.0*
Total	**5,151**	**5,677**	**5,350**	**6,061**	**7,484**
Growth (%)	***9.8***	***10.2***	***(5.8)***	***13.3***	***23.5***

Source: HDFC sec Inst Research

Peer Valuations

	Mcap (Rs bn)	CMP (Rs/sh)	Reco	TP	Adj EPS (Rs/sh)				P/E (x)				RoE (%)			
					FY17	FY18E	FY19E	FY20E	FY17	FY18E	FY19E	FY20E	FY17	FY18E	FY19E	FY20E
Sun Pharma	1,136	472	NEU	544	26.0	14.0	20.1	27.2	18.2	33.8	23.4	17.4	17.9	9.1	12.3	14.8
Cipla	461	574	NEU	631	12.5	18.4	25.7	33.2	45.9	31.1	22.3	17.3	8.4	11.2	14.0	15.8
Cadila Healthcare	403	393	BUY	523	14.5	11.3	16.4	22.7	27.0	34.7	24.0	17.3	23.5	15.4	19.0	22.3
Aurobindo Pharma	357	609	BUY	835	39.3	35.2	46.0	52.2	15.5	17.3	13.3	11.7	27.6	20.0	21.4	20.0
Lupin	338	752	BUY	1,219	33.4	18.5	43.9	64.2	22.6	40.6	17.1	11.7	12.2	6.1	13.3	17.2
Dr Reddy's Labs	338	1,991	NEU	2,320	72.7	64.7	116.0	161.0	27.4	30.8	17.2	12.4	9.5	8.4	13.9	17.0
Divi's Labs	319	1,201	NEU	1,100	39.9	33.4	44.9	51.7	30.1	35.9	26.7	23.2	22.0	15.7	18.8	19.0
Alkem Laboratories	239	1,995	BUY	2,124	74.6	62.6	85.0	106.2	26.7	31.9	23.5	18.8	21.9	15.8	18.8	20.2
Torrent Pharma	231	1,363	BUY	1,748	51.2	38.9	62.0	79.5	26.6	35.0	22.0	17.2	22.1	14.9	21.5	23.2
Glenmark	146	516	BUY	781	29.6	18.5	30.0	43.8	17.4	27.9	17.2	11.8	18.1	9.8	14.0	17.5
Jubilant Life Sciences	134	861	BUY	1,060	37.0	46.6	65.5	80.4	23.3	18.5	13.1	10.7	18.0	19.3	22.4	22.5
Alembic Pharma	92	489	NEU	575	21.4	23.1	25.2	31.9	22.8	21.1	19.4	15.3	23.0	21.1	19.7	21.1
Dishman Carbogen Amcis	56	345	BUY	480	9.0	9.9	15.2	22.4	38.3	34.9	22.7	15.4	3.0	3.3	4.9	6.8
Strides Shasun	48	533	BUY	980	34.0	27.7	39.0	59.4	15.7	19.2	13.7	9.0	13.1	4.6	12.9	17.1
Granules India	24	94	BUY	177	7.5	6.0	8.5	11.8	12.5	15.7	11.1	8.0	21.0	13.7	15.3	18.9
Neuland Labs	**12**	**787**	**BUY**	**1,000**	**42.6**	**11.0**	**28.9**	**62.3**	**18.5**	**72.0**	**27.4**	**12.7**	**12.8**	**2.2**	**5.5**	**11.1**

Source: HDFC sec Inst Research

Income Statement (Consolidated)

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenues	**5,100**	**5,789**	**5,274**	**6,041**	**7,459**
Growth (%)	***8.7***	***13.5***	***(8.9)***	***14.5***	***23.5***
Material Expenses	2,535	2,629	2,384	2,658	3,170
Employee Expenses	557	927	1,030	1,130	1,283
Other Operating Expenses	514	462	425	453	559
EBITDA	**685**	**707**	**931**	**979**	**1,119**
EBITDA Margin (%)	**809**	**1,063**	**504**	**822**	**1,328**
EBITDA Growth (%)	***15.9***	***18.4***	***9.6***	***13.6***	***17.8***
Depreciation	21.4	31.5	(52.6)	62.9	61.6
EBIT	**157**	**192**	**221**	**263**	**315**
Other Income (Including EO Items)	651	871	283	558	1,013
Interest	18	12	45	55	65
PBT	**249**	**211**	**189**	**211**	**210**
Tax (Incl Deferred)	420	672	139	402	868
RPAT	**149**	**203**	**19**	**84**	**182**
Minority Interest	271	469	121	317	685
EO (Loss) / Profit (Net Of Tax)	(2)	-	0	0	0
APAT	**269**	**469**	**121**	**317**	**685**
APAT Growth (%)	***68.2***	***74.5***	***(74.3)***	***163.1***	***115.9***
Adjusted EPS (Rs)	**30.9**	**42.6**	**11.0**	**28.9**	**62.3**

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
SOURCES OF FUNDS					
Share Capital - Equity	90	90	90	90	90
Reserves	1,777	5,367	5,491	5,778	6,397
Total Shareholders Funds	**1,866**	**5,456**	**5,580**	**5,867**	**6,487**
Long Term Debt	1,700	298	1,035	1,010	985
Short Term Debt	120	1,511	1,992	2,002	2,012
Total Debt	**1,820**	**1,809**	**3,027**	**3,012**	**2,997**
Net Deferred Taxes	146	151	128	151	151
Long Term Provisions & Others	94	95	302	313	313
TOTAL SOURCES OF FUNDS	**3,927**	**7,511**	**9,037**	**9,343**	**9,948**
APPLICATION OF FUNDS					
Net Block	1,388	4,655	4,748	5,935	3,375
CWIP	405	196	1,261	600	400
Investments	74	4	4	4	4
LT Loans & Advances	232	250	229	125	125
Total Non-current Assets	**2,099**	**5,105**	**6,242**	**6,664**	**3,904**
Inventories	1,267	1,351	1,751	1,384	1,563
Debtors	1,191	1,811	1,939	1,738	2,044
Other Current Assets	587	388	534	206	213
Cash & Equivalents	97	200	248	758	1,116
Total Current Assets	**3,142**	**3,750**	**4,472**	**4,085**	**4,936**
Creditors	931	859	1,243	983	1,172
Other Current Liabilities & Provns	383	486	434	737	829
Total Current Liabilities	**1,314**	**1,345**	**1,677**	**1,720**	**2,001**
Net Current Assets	**1,828**	**2,405**	**2,795**	**2,365**	**2,935**
TOTAL APPLICATION OF FUNDS	**3,927**	**7,511**	**9,037**	**9,029**	**6,839**

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	420	672	139	402	868
Non-operating & EO items	30	139	(69)	(32)	(65)
Interest expenses	150	211	189	211	210
Depreciation	157	192	221	263	315
Working Capital Change	(192)	(491)	(114)	1,055	(211)
Tax Paid	(117)	(203)	(19)	(84)	(182)
OPERATING CASH FLOW (a)	**448**	**520**	**349**	**1,815**	**934**
Capex	(193)	(457)	(1,379)	(789)	(350)
Free cash flow (FCF)	*255*	*63*	*(1,030)*	*1,026*	*584*
Investments	(14)	-	-	-	-
Non-operating Income	8	70	(0)	-	-
INVESTING CASH FLOW (b)	**(199)**	**(387)**	**(1,379)**	**(789)**	**(350)**
Debt Issuance/(Repaid)	(57)	(11)	1,218	(15)	(15)
Interest Expenses	(163)	(199)	(144)	(156)	(145)
FCFE	*30*	*(77)*	*44*	*855*	*424*
Share Capital Issuance	-	0	-	-	-
Dividend	(16)	(37)	(10)	(30)	(66)
Others	14	(121)	-	(314)	-
FINANCING CASH FLOW (c)	**(222)**	**(368)**	**1,064**	**(516)**	**(226)**
NET CASH FLOW (a+b+c)	**28**	**(235)**	**34**	**510**	**358**
Closing Cash & Equivalents	**98**	**(138)**	**234**	**758**	**1,116**

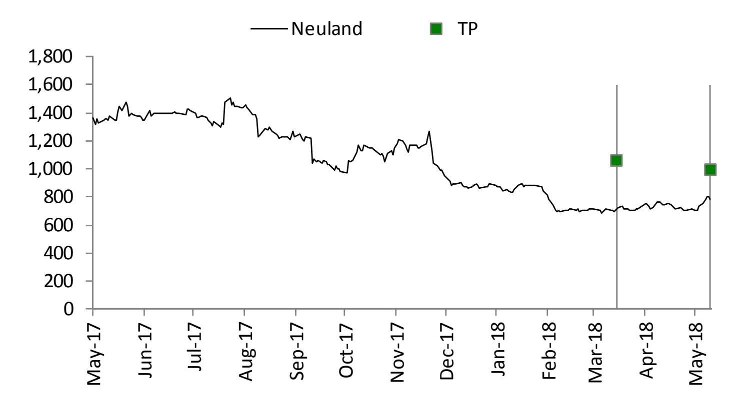
Source: Company, HDFC sec Inst Research

Key Ratios

	FY16	FY17	FY18E	FY19E	FY20E
PROFITABILITY (%)					
GPM	50.3	54.6	54.8	56.0	57.5
EBITDA Margin	15.9	18.4	9.6	13.6	17.8
APAT Margin	5.4	8.1	2.3	5.3	9.2
RoE	15.7	12.8	2.2	5.5	11.1
RoIC (or Core RoCE)	12.3	11.5	3.1	5.3	14.7
RoCE	11.2	10.8	3.4	5.4	11.3
EFFICIENCY					
Tax Rate (%)	35.5	30.2	13.4	21.0	21.0
Fixed Asset Turnover (x)	1.7	1.6	1.4	1.1	1.3
Inventory (days)	*90.7*	*85.2*	*121.2*	*83.6*	*76.5*
Debtors (days)	*85.3*	*114.2*	*134.2*	*105.0*	*100.0*
Other Current Assets (days)	*42.0*	*24.5*	*37.0*	*12.4*	*10.4*
Payables (days)	*66.6*	*54.2*	*86.0*	*59.4*	*57.4*
Other Current Liab & Provns (days)	*27.4*	*30.6*	*30.1*	*44.5*	*40.6*
Cash Conversion Cycle (days)	*123.9*	*139.1*	*176.3*	*97.1*	*89.0*
Debt/EBITDA (x)	2.3	1.7	6.0	3.7	2.3
Net D/E (x)	0.9	0.3	0.5	0.4	0.3
Interest Coverage (x)	2.6	4.1	1.5	2.6	4.8
PER SHARE DATA (Rs)					
EPS	30.9	42.6	11.0	28.9	62.3
Dividend	2.0	2.8	0.8	2.3	5.0
Book Value	211.1	496.0	507.3	533.4	589.7
VALUATION					
P/E (x)	25.5	18.5	72.0	27.4	12.7
P/BV (x)	3.7	1.6	1.6	1.5	1.3
EV/EBITDA (x)	10.8	9.7	22.7	13.3	8.0
EV/Revenues (x)	1.7	1.8	2.2	1.8	1.4
OCF/EV (%)	5.1	5.0	3.0	16.6	8.8
FCF/EV (%)	2.9	0.6	(9.0)	9.4	5.5
FCFE/Mkt Cap (%)	0.4	(0.9)	0.5	9.8	4.9
Dividend Yield (%)	0.3	0.4	0.1	0.3	0.6

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
15-Mar-18	704	BUY	1,065
11-May-18	787	BUY	1,000

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

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