

## Covid drags FY21; new launches to drive FY22...

Natco's Q4FY21 revenues de-grew 27.2% YoY to ₹ 331.3 crore due to decline across verticals. Export formulations declined 27.6% YoY to ₹ 158.8 crore due to significant drop in gTamiflu sales. Domestic formulations de-grew 20.3% to ₹ 81.8 crore amid a sharp fall in oncology sales. API business declined 26.6% YoY ₹ 70.8 crore. EBITDA margins contracted 521 bps YoY to 23%, mainly due to higher employee cost. EBITDA fell 40.6% YoY to ₹ 76.2 crore. Ensuing PAT declined 43.7% YoY to ₹ 53 crore.

### Focused approach in US

Natco has carved out its own identity via tie-ups to tap limited but niche products pipeline including 20 Para IVs filings (FY20). As per the revised and more feasible game plan, it plans to market products via tie-ups with established players in the generic space. Till FY20, the company had filed 55 ANDAs, which includes some niche FTF opportunities. Overall, the management expects one or two complex product launches in the US.

### New launches in CND/oncology to drive domestic revenues

Natco is a leading player in the domestic oncology segment with a product basket of ~33 products (FY20). Covid related disturbances and pricing pressure notwithstanding, we expect momentum in oncology segment to be decent on the back of incremental launches. New launches in cardio/diabetology segment (CND) is also expected to support overall growth. Going ahead, Natco is looking to launch 10 products a year. We expect domestic sales to grow at 21.4% CAGR in FY20-23E to ₹ 611 crore.

### Valuation & Outlook

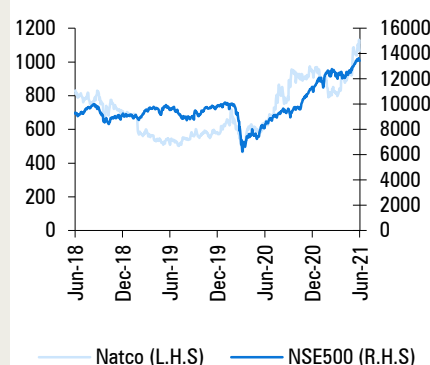
Q4 and FY21 performance was way lower than the management guidance amid Covid impact. However, the management expects strong growth in FY22 due to multiple high value product launches in the US, rebound in domestic India business with new products and contribution from crop health division. While all eyes are on gRevlimid launch in March 22, the company also has a handful of other niche US approvals and launches lined up. Broadly, given the current trend in the US with niche opportunities being specifically targeted by USFDA to encourage more generic players, this funnel is getting squeezed. In this backdrop, the management is looking to expand in other geographies, businesses (agrochemicals). As per new strategy, specific markets - India, Brazil, Canada, China, agrochemical segment, together are likely to contribute 70-80% of revenues in the medium to long term. The bright spot for Natco is of course its strong balance sheet besides the management's ability to carve out a niche out of the available opportunities. The growth trajectory is likely to improve from here on as the new strategy takes shape. We ascribe a target price of ₹ 1010 (earlier ₹ 885), which includes base business value of ~₹ 815 (35x FY23E EPS of ₹ 23.3) + ₹ 195 for NPV for gRevlimid. We maintain **HOLD**.



#### Particulars

Particular	Amount
Market Capitalisation	₹ 19500 crore
Debt (FY21)	₹ 268 crore
Cash (FY21)	₹ 284 crore
EV	₹ 19484 crore
52 week H/L (₹)	1189/596
Equity capital	₹ 36.5 crore
Face value	₹ 2

#### Price performance



#### Key risks to our call

- Higher-than-expected competition in the US key products
- Better-than-expected market share gain from new products

#### Research Analyst

Siddhant Khandekar  
siddhant.khandekar@icicisecurities.com

Mitesh Shah  
mitesh.shah@icicisecurities.com

#### Key Financial Summary

(₹ crore)	FY20	FY21	FY22E	FY23E	CAGR FY21-23E (%)
Revenues	1915.0	2052.1	1985.5	2120.1	1.6
EBITDA	582.6	606.2	524.7	621.4	1.2
EBITDA Margins (%)	30.4	29.5	26.4	29.3	
Net Profit	460.8	440.9	355.8	424.7	-1.9
EPS (₹)	25.3	24.2	19.5	23.3	
PE (x)	42.3	44.2	54.8	45.9	
EV to EBITDA (x)	33.9	31.9	36.5	30.3	
RoNW (%)	12.2	10.7	8.1	9.1	
RoCE (%)	14.0	13.1	10.1	11.2	

**Exhibit 1: Variance Analysis**

	Q4FY21	Q4FY20	Q3FY21	YoY (%)	QoQ (%)	Comments
Revenue	331.3	454.8	355.2	-27.2	-6.7	Sharp decline amid Covid impact, lower Tamiflu sales (exports) and lower oncology sales (domestic)
Raw Material Expenses	54.5	94.9	83.1	-42.6	-34.4	Sharp decline mainly due to change in product mix
Employee Expenses	94.6	81.6	101.4	15.9	-6.7	
Other Expenditure	106.0	150.0	88.2	-29.3	20.2	
Total Operating Expenditure	255.1	326.5	272.7	-21.9	-6.5	
EBITDA	76.2	128.3	82.5	-40.6	-7.6	
EBITDA (%)	23.0	28.2	23.2	-521 bps	-23 bps	YoY contraction amid negative operational leverage
Interest	3.5	3.5	3.4	0.0	2.9	
Depreciation	30.4	30.5	29.8	-0.3	2.0	
Other Income	28.4	22.4	30.8	26.8	-7.8	
EO	0.0	0.0	0.0	0.0	0.0	
PBT	70.7	116.7	80.1	-39.4	-11.7	
Tax	17.7	23.5	16.7	-24.7	6.0	
PAT before MI	53.0	93.2	63.4	-43.1	-16.4	
MI	0.0	-0.9	0.7	0.0	0.0	
Adj.Net Profit	53.0	94.1	62.7	-43.7	-15.5	YoY decline mainly in sync with operational performance
<b>Key Metrics</b>						
Domestic formulations	83.1	102.6	95.3	-19.0	-12.8	YoY decline amid sharp decline in oncology segment amid Covid-19, price erosion and price control
Export Formulations	158.8	219.4	162.1	-27.6	-2.0	Sharp decline amid vanished Tamiflu sales
APIs	70.8	96.4	97.8	-26.6	-27.6	Sharp decline amid vanished Tamiflu sales

Source: ICICI Direct Research

**Exhibit 2: Change in Estimates**

	FY22E			FY23E			Comments
	Old	New	% Change	Old	New	% Change	
(₹ Crore)							
Revenue	2,332.1	1,985.5	-14.9	2,376.6	2,120.1	-10.8	Changed mainly due to lower-than-expected domestic oncology and API revenues in FY21
EBITDA	721.3	524.7	-27.3	708.2	621.4	-12.3	
EBITDA Margin (%)	30.9	26.4	-450 bps	29.8	29.3	-49 bps	Declined mainly due to lower-than-expected margins in FY21 and expected change in product mix
PAT	510.5	355.8	-30.3	492.6	424.7	-13.8	Declined mainly in sync with operational performance
EPS (₹)	28.0	19.5	-30.3	27.0	23.3	-13.8	

Source: ICICI Direct Research

**Exhibit 3: Change in Estimates**

	Current			Earlier			Comments
	FY20	FY21	FY22E	FY23E	FY22E	FY23E	
APIs	355.2	512.2	339.2	373.1	463.5	509.9	Declined mainly due to lower-than-expected sales in FY21
Domestic formulations	540.8	414.4	518.3	610.9	701.4	768.0	Declined mainly due to lower-than-expected sales in FY21
Exports formulations	932.6	1,077.1	1,073.6	1,078.1	1,100.5	1,030.8	Increased mainly due to expectation of some limited competition launches in FY22

Source: ICICI Direct Research

## Conference Call Highlights

- The management expects strong growth in FY22 due to multiple high value product launches in the US, rebound in domestic India business with new products and contribution from crop health division
- Domestic business – The pandemic hit the domestic business in Q4 and FY21
  - Oncology segment – Chemo is a significant part of the company that was impacted the most amid 1) Covid, 2) price erosion and 3) price control by the government. It expects growth in FY22 amid new launches
  - Expects Covid therapies to drive Q1
  - Molnupiravir – Clinical trials going on, no patent as yet
  - Hepatitis - C -- Sales were less than ₹ 10 crore in Q4FY21
  - Expects 10-12 launches in the domestic market in FY22
- Agrochemical – Expects two products to contribute in FY22
  - Feromon pink bollworm (PBW) product for cotton crops. It is first in market in India. Cotton crop season is between June and August in India. Initially, the company will focus on four states AP, Telangana, Gujarat and Madhya Pradesh
  - 2) CTPR (Chlorantraniliprole) – The court judgement is expected in July 2021; 65-70% usage in Kharif and 30-35% usage is Rabi season
- Revlimid –
  - Launch is expected in March 22 as first generic player
  - Natco will have a 30% profitability share for Revlimid
- US business –
  - Base business was almost steady in Q4
  - Q4 impacted as Tamiflu opportunity has completely vanished
  - Targeting seven to eight products in FY22 including three to four limited competition opportunities like Everolimus (used for oncology and as an immunosuppressant)
- Working Capital – Build-up inventories for pandemic drugs and agro business
- As per management, Q1FY22 is expected to be better than Q4FY21
- The company is looking at inorganic opportunities for US front end and niche products

Exhibit 4: Trends in quarterly financials

₹ Crore	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	YoY (%)	QoQ (%)
Revenues	767.8	538.6	543.5	556.7	455.7	492.3	485.7	482.2	454.8	563.4	802.2	361.1	331.3	-27.2	-8.3
Raw Material Expens	123.0	87.3	94.9	105.0	67.0	76.0	119.2	91.5	94.9	178.9	194.9	83.1	54.5	-42.6	-34.4
% of Revenues	16.0	16.2	17.5	18.9	14.7	15.4	24.5	19.0	20.9	31.8	24.3	23.0	16.5	-442 bps	-656 bps
Gross Profit	644.8	451.3	448.6	451.7	388.7	416.3	366.5	390.7	359.9	384.5	607.3	278.0	276.8	-23.1	-0.4
Gross Profit Margin (%)	84.0	83.8	82.5	81.1	85.3	84.6	75.5	81.0	79.1	68.2	75.7	77.0	83.5	442 bps	656 bps
Employee Expenses	110.1	88.7	92.6	93.3	81.3	93.2	102.4	97.8	81.6	95.2	123.7	101.4	94.6	15.9	-6.7
% of Revenues	14.3	16.5	17.0	16.8	17.8	18.9	21.1	20.3	17.9	16.9	15.4	28.1	28.6	1061 bps	47 bps
Other Expenses	151.4	145.0	135.5	150.0	159.1	131.8	129.8	164.2	150.0	118.2	207.2	88.2	106.0	-29.3	20.2
% of Revenues	19.7	26.9	24.9	26.9	34.9	26.8	26.7	34.1	33.0	21.0	25.8	24.4	32.0	-99 bps	757 bps
Total Expenditure	384.5	321.0	323.0	348.3	307.4	301.0	351.4	353.5	326.5	392.3	525.8	272.7	255.1	-21.9	-6.5
% of Revenues	50.1	59.6	59.4	62.6	67.5	61.1	72.3	73.3	71.8	69.6	65.5	75.5	77.0	521 bps	148 bps
EBITDA	383.3	217.6	220.5	208.4	148.3	191.3	134.3	128.7	128.3	171.1	276.4	88.4	76.2	-40.6	-13.8
EBITDA Margins(%)	49.9	40.4	40.6	37.4	32.5	38.9	27.7	26.7	28.2	30.4	34.5	24.5	23.0	-521 bps	-148 bps
Depreciation	18.0	18.4	20.2	20.7	21.7	22.0	21.9	25.4	30.5	28.0	28.7	29.8	30.4	-0.3	2.0
Interest	3.0	2.8	5.0	6.3	5.2	6.5	6.2	5.3	3.5	3.7	2.7	3.4	3.5	0.0	2.9
Other income	20.1	35.9	40.0	23.3	31.0	21.0	33.2	30.8	22.4	18.7	25.7	30.8	28.4	26.8	-7.8
Less: Exceptional Ite	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
PBT	382.4	232.3	235.3	204.7	152.4	183.8	139.4	128.8	116.7	158.1	270.7	86.0	70.7	-39.4	-17.8
Total Tax	82.7	51.2	53.7	45.4	32.0	41.0	21.7	24.4	23.5	36.0	66.8	16.7	17.7	-24.7	6.0
Tax rate (%)	21.6	22.0	22.8	22.2	21.0	22.3	15.6	18.9	20.1	22.8	24.7	19.4	25.0		
PAT	299.7	181.1	181.6	159.3	120.4	142.8	117.7	104.4	93.2	122.1	203.9	69.3	53.0	-43.1	-23.5
PAT Margin (%)	39.0	33.6	33.4	28.6	26.4	29.0	24.2	21.7	20.5	21.7	25.4	19.2	16.0	-449 bps	-319 bps
Minority Interest	-0.2	-0.5	-0.9	-0.2	-0.4	-0.4	-1.3	-0.1	-0.9	-0.7	1.5	0.7	0.0		
PAT after MI	299.9	181.6	182.5	159.5	120.8	143.2	119.0	104.5	94.1	122.8	202.4	68.6	53.0	-43.7	-22.7
EPS (₹)	16.5	10.0	10.0	8.8	6.6	7.9	6.5	5.7	5.2	6.7	11.1	3.8	2.9		
Adj PAT	299.9	181.6	182.5	159.5	120.8	143.2	119.0	104.5	94.1	122.8	202.4	68.6	53.0	-43.7	-22.7

Source: ICICI Direct Research

## Company Background

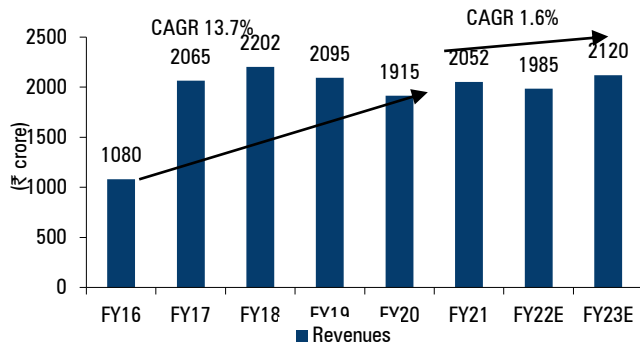
Natco Pharma (NPL) is a mid-sized pharmaceutical company with a presence across the pharma value chain. The company also has a US retail business. It owns eight manufacturing facilities including six formulations facilities and two API facilities. Overall revenues grew at a CAGR of 13.7% in FY16-21.

Natco is a leading domestic player in the oncology space. NPL's product pipeline consists of drugs, which are used for various types of cancers like blood cancer, breast cancer, brain cancer, ovarian cancer, lung cancer and prostate cancer. Currently, Natco is marketing 33 oncology products in the Indian market (FY20).

On the export front, Natco exports products to the US, Canada and Europe regions. Despite being a late entrant in the US market, it has carved out its own identity via tie-ups to tap limited but niche products pipeline including 20 Para IVs and two limited competition products. The products, which have first to file status, are Lenalidomide capsules, Lanthanum Carbonate chewable tablets, Lapatinib Ditosylate tablets and Bendamustine Hydrochloride powder. There are still more such candidates in the pipeline.

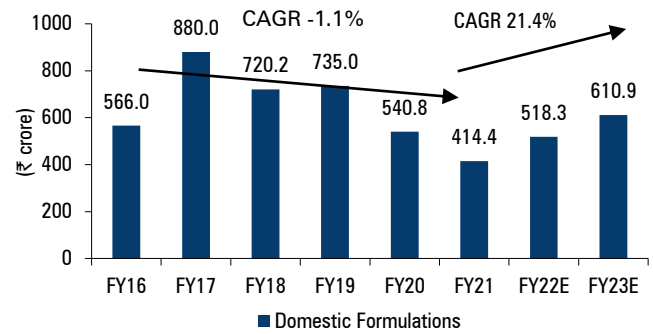
The management has charted a new growth roadmap with plans to enter the agrochemical business. Subsequently, the company filed a broad spectrum insecticide, Chlorantraniliprole (CTPR) in India for which it expects approval from agricultural ministry shortly. Natco has invested ~₹ 100 crore in this segment till date. Additionally, the company has filed another agro product (undisclosed) recently. Overall, the management expects this segment to contribute ~10-15% of overall revenues two to three years down the line.

Exhibit 5: Revenues grow at CAGR of ~1.6% over FY21-23E



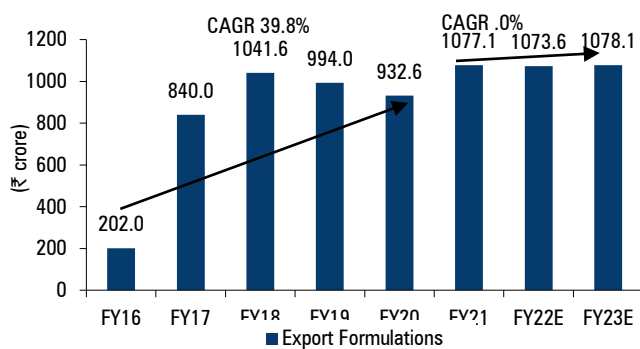
Source: ICICI Direct Research, Company

Exhibit 6: Domestic to grow at CAGR of 21% over FY21-23E



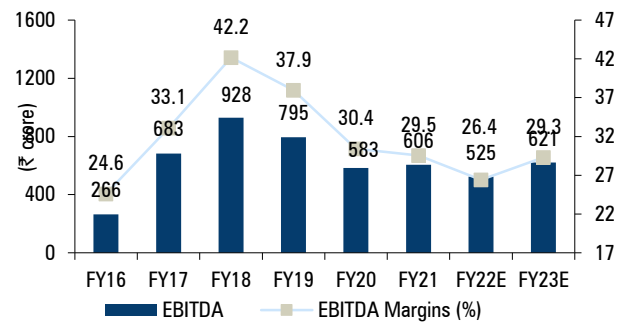
Source: ICICI Direct Research, Company

Exhibit 7: Muted export formulations growth expected in FY21-23E



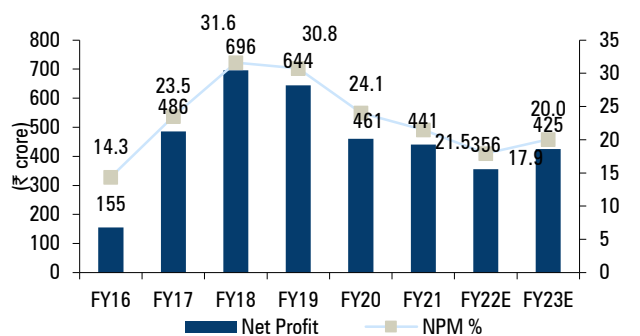
Source: ICICI Direct Research, Company

Exhibit 8: EBITDA & EBITDA margins trend



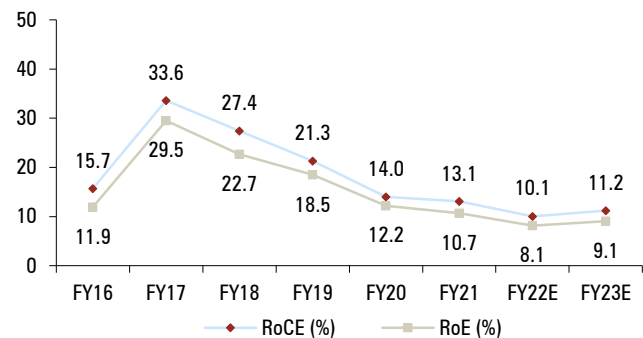
Source: ICICI Direct Research, Company

Exhibit 9: Net profit & net profit margins trend



Source: ICICI Direct Research, Company

Exhibit 10: RoE & RoCE trend



Source: ICICI Direct Research, Company

Exhibit 11: Valuation Summary

	Revenues	Growth	EPS	Growth	P/E	EV/EBITDA	RoE	RoCE
	(₹ crore)	(%)	(₹)	(%)	(x)	(X)	(%)	(%)
FY20	1915	-8.6	25.3	-28.5	42.3	33.9	12.2	14.0
FY21	2052	7.2	24.2	-4.3	44.2	31.9	10.7	13.1
FY22E	1985	-3.2	19.5	-19.3	54.8	36.5	8.1	10.1
FY23E	2120	6.8	23.3	19.4	45.9	30.3	9.1	11.2

Source: ICICI Direct Research, Bloomberg

Exhibit 12: Shareholding Pattern

(in %)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Promoter	48.9	48.9	48.9	48.9	48.9
Others	51.1	51.1	51.1	51.1	51.1

Source: ICICI Direct Research, Company

## Financial Summary

Exhibit 13: Profit & Loss (₹ crore)

(Year-end March)	FY20	FY21	FY22E	FY23E
<b>Revenues</b>	<b>1,915.0</b>	<b>2,052.1</b>	<b>1,985.5</b>	<b>2,120.1</b>
Growth (%)	-8.6	7.2	-3.2	6.8
Raw Material Expenses	381.6	511.4	476.5	466.4
Employee Expenses	375.0	414.9	418.3	435.5
Other expenses	575.8	519.6	565.9	596.8
Total Operating Expenditure	1,332.4	1,445.9	1,460.7	1,498.7
<b>EBITDA</b>	<b>582.6</b>	<b>606.2</b>	<b>524.7</b>	<b>621.4</b>
Growth(%)	-26.7	4.1	-13.4	18.4
Depreciation	99.8	116.9	132.0	147.2
Interest	21.5	13.3	13.4	13.4
Other Income	107.4	103.6	88.8	97.9
PBT	568.7	579.6	468.2	558.8
Total Tax	110.6	137.2	112.4	134.1
PAT before MI	458.1	442.4	355.8	424.7
Minority Interest	-2.7	1.5	0.0	0.0
<b>Adjusted PAT</b>	<b>460.8</b>	<b>440.9</b>	<b>355.8</b>	<b>424.7</b>
Growth(%)	-28.5	-4.3	-19.3	19.4
<b>EPS (Adjusted)</b>	<b>25.3</b>	<b>24.2</b>	<b>19.5</b>	<b>23.3</b>

Source: ICICI Direct Research

Exhibit 14: Cash Flow Statement (₹ crore)

(Year-end March)	FY20	FY21	FY22E	FY23E
Profit/(Loss) after taxation	460.9	449.6	355.8	424.7
Add: Depreciation	99.8	116.9	132.0	147.2
(Inc)/dec in Current Assets	-151.2	-122.5	42.7	110.3
Inc/(dec) in CL and Provisions	53.6	-90.4	3.9	19.3
Others	-45.8	-54.8	13.4	13.4
<b>CF from operating activities</b>	<b>417.3</b>	<b>298.8</b>	<b>547.8</b>	<b>714.8</b>
(Purchase)/Sale of Fixed Assets	-336.5	-207.2	-250.0	-250.0
(Increase)/Decrease in Investments	53.0	-177.3	-200.0	-400.0
Others	-96.5	488.9	3.5	3.8
<b>CF from investing activities</b>	<b>-380.0</b>	<b>104.4</b>	<b>-446.5</b>	<b>-646.2</b>
Inc / (Dec) in Equity Capital	0.1	0.1	0.0	0.0
Inc / (Dec) in Loan	0.0	0.0	0.0	0.0
Dividend & Dividend tax	-153.6	-113.9	-109.4	-109.4
Others	-97.3	-71.9	-13.4	-13.4
<b>CF from financing activities</b>	<b>-250.8</b>	<b>-185.7</b>	<b>-122.8</b>	<b>-122.8</b>
Net Cash flow	-213.5	217.5	-21.5	-54.1
Opening Cash	279.5	66.0	283.5	262.0
<b>Closing Cash</b>	<b>66.0</b>	<b>283.5</b>	<b>262.0</b>	<b>207.8</b>
<b>Free Cash Flow</b>	<b>80.8</b>	<b>91.6</b>	<b>297.8</b>	<b>464.8</b>

Source: ICICI Direct Research

Exhibit 15: Balance Sheet (₹ crore)

(Year-end March)	FY20	FY21	FY22E	FY23E
Equity Capital	36.4	36.5	36.5	36.5
Reserve and Surplus	3,737.1	4,085.1	4,331.5	4,646.8
Total Shareholders funds	3,773.5	4,121.6	4,368.0	4,683.3
Total Debt	315.9	267.6	267.6	267.6
Deferred Tax Liability	25.9	41.3	44.6	48.2
Minority Interest / Others	12.0	2.9	3.1	3.4
Long Term Provisions	90.2	99.6	99.6	99.6
<b>Total Liabilities</b>	<b>4,217.5</b>	<b>4,533.0</b>	<b>4,782.9</b>	<b>5,102.0</b>
Gross Block - Fixed Assets	2,148.6	2,704.3	3,054.3	3,404.3
Accumulated Depreciation	564.2	681.1	813.1	960.3
Net Block	1,584.4	2,023.2	2,241.2	2,444.0
Capital WIP	518.0	223.4	123.4	23.4
Total Fixed Assets	2,102.4	2,246.6	2,364.6	2,467.4
Investments	112.3	303.7	503.7	903.7
Inventory	558.0	798.2	770.1	632.8
Debtors	551.3	412.9	398.3	425.4
Cash	66.0	283.5	262.0	207.8
Other Current Assets	1,121.6	698.4	698.4	698.4
Total Current Assets	2,296.9	2,193.0	2,128.8	1,964.4
Creditors	255.4	146.2	141.0	150.6
Provisions	10.5	12.8	13.8	14.9
Other Current Liabilities	104.4	99.9	107.9	116.5
Total Current Liabilities	370.3	258.9	262.8	282.1
Net Current Assets	1,926.6	1,934.1	1,866.0	1,682.3
LT L & A & Other Non CA	76.2	48.6	48.6	48.6
<b>Application of Funds</b>	<b>4,217.5</b>	<b>4,533.0</b>	<b>4,782.9</b>	<b>5,102.0</b>

Source: ICICI Direct Research

Exhibit 16: Key Ratios

(Year-end March)	FY20	FY21	FY22E	FY23E
<b>Per share data (₹)</b>				
Adjusted EPS	25.3	24.2	19.5	23.3
BV per share	207.0	226.0	239.6	256.8
Dividend per share	6.8	5.3	6.0	6.0
Cash Per Share	3.6	15.5	14.4	11.4
<b>Operating Ratios (%)</b>				
Gross Profit Margins	80.1	75.1	76.0	78.0
EBITDA Margins	30.4	29.5	26.4	29.3
PAT Margins	24.1	21.5	17.9	20.0
Inventory days	106.4	142.0	141.6	108.9
Debtor days	105.1	73.4	73.2	73.2
Creditor days	48.7	26.0	25.9	25.9
Asset Turnover	0.9	0.8	0.7	0.6
EBITDA Conversion Rate	79.5	58.3	101.8	112.9
<b>Return Ratios (%)</b>				
RoE	12.2	10.7	8.1	9.1
RoCE	14.0	13.1	10.1	11.2
RoIC	13.4	12.6	9.7	11.5
<b>Valuation Ratios (x)</b>				
P/E	42.3	44.2	54.8	45.9
EV / EBITDA	33.9	31.9	36.5	30.3
EV / Net Sales	10.3	9.4	9.7	8.9
Market Cap / Sales	10.2	9.5	9.8	9.2
Price to Book Value	5.2	4.7	4.5	4.2
<b>Solvency Ratios</b>				
Debt / EBITDA	0.5	0.4	0.5	0.4
Debt / Equity	0.1	0.1	0.1	0.1
<b>Current Ratio</b>	<b>6.0</b>	<b>7.4</b>	<b>7.1</b>	<b>6.2</b>
Working Capital Cycle	162.8	189.4	188.9	156.2

Source: ICICI Direct Research

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Buy: >15%;

Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: <-15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,  
ICICI Securities Limited,  
1st Floor, Akruvi Trade Centre,  
Road No 7, MIDC,  
Andheri (East)  
Mumbai – 400 093  
research@icicidirect.com



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