Sharekhan by BNP PARIBAS

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Zydus Lifesciences Ltd

US performance to be strained in near term; India outlook stays strong

Consumer Goods	Sharekhan code: ZYDUSLIFE

Reco/View: Buy	↔	CMP: **Rs. 369**	Price Target: **Rs. 480**	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We retain a Buy recommendation on the stock of Zydus Lifesciences with revised PT of Rs. 480
- Zydus Lifesciences' US business has a healthy growth outlook over the long term supported by a strong pipeline of new products, though in the near term headwinds in the form of slow product / plant approvals and pricing pressures would play dampeners.
- The growth prospects in India markets are bright backed by a revival in the acute as well as Chronic therapies coupled with likely market share gains in key therapy areas. Growth prospects in the emerging markets are strong as well.
- Q4FY22 is expected to a quarter of weak performance for Zydus Lifesciences' reflecting elevated cost pressures.

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 41.35

Updated Feb 08, 2022

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

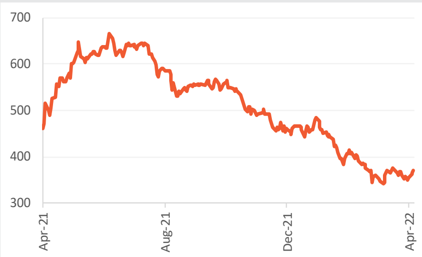
Company details

Market cap:	Rs. 37,801 cr
52-week high/low:	Rs. 674 / 331
NSE volume: (No of shares)	19.4 lakh
BSE code:	532321
NSE code:	ZYDUSLIFE
Free float: (No of shares)	25.7 cr

Shareholding (%)

Promoters	74.9
FII	4.1
DII	11.8
Others	9.25

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.0	-18.0	-32.8	-19.9
Relative to Sensex	-3.7	-16.8	-31.7	-38.8

Sharekhan Research, Bloomberg

Zydus Lifesciences India business is expected to grow in double digits for FY23 backed by robust growth outlook, while the US revenues are expected to clock a modest low to mid-single digit growth. Sustained pricing pressures and a delayed new product launches and clearance for Moraiya plant, would slow down the growth for US business in near term while substantial high value launches lined up and likely ramp up in exiting business, the US sales are expected to clock a strong growth in FY24. Q4FY22 is also expected to a quarter of weak performance for Zydus Lifesciences' with the earnings expected to decline by double digits y-o-y due to elevated cost pressures.

- **Near term headwinds to stay for US business; strong product pipeline a long-term driver:** Zydus Lifesciences' US business has a healthy growth outlook over the long term supported by a strong pipeline of new products including few high value launches. The impact of the same is expected to be reflected in FY24 onwards. Also the company has had a strong pipeline of new products launched in past one year, which would ramp up and fuel the growth. However, in the near term, sustained pricing pressures in the generics segment, slower product approvals and delay for Maraiya plant clearance would play the dampeners and slow down the US sales growth momentum.
- **Robust outlook for Domestic business backed by new launches:** Zydus Lifesciences' domestic formulations business is expected to sustain the strong growth traction driven by growth across chronic and acute therapies including market share gains in key therapies. Further plans to launch Desidustat (high potential product) and launch of 2 biosimilars in previous year (which could ramp up) in India markets coupled with strong brand position and well-spread distribution reach and broadening of the product portfolio would be key growth drivers for India business.
- **Q4FY22 likely to be a weak quarter:** Zydus Lifesciences' is expected to report a weak set of results for Q4FY22. While the India business is expected to stage a strong growth, the US sales are likely to remain under pressure marred by higher price erosion. This coupled with a elevated cost pressures due to higher raw material and freight costs would exert margins pressures leading to a decline in PAT. The Q4FY22 revenues are expected to grow by a modest 1.5% y-o-y while the earnings are expected to post a double-digit decline y-o-y basis.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 480: Zydus Lifesciences' growth prospects in India as well as in emerging markets stay bright while that in the US markets growth is likely to moderate in the near term due to heightened pricing pressures. Further the vaccines opportunity in the domestic markets has also moderated. Also, elevated cost pressures are likely to impact the Q4 performance leading to a doble digit earnings decline. At CMP, the stock trades at 17.4x/15x/12.8x its FY22E/FY23E and FY24E EPS. The stock price has corrected by ~33% in the past six months and the valuations now look reasonable. Basis the expected strong outlook for the India business and other Emerging Markets we retain Buy recommendation on the stock with revised PT of Rs. 480.

Key Risks

1) Price erosion in the US generics business could hurt performance. 2) A delay in resolution of USFDA issues at Moraiya plant. 3) Forex volatility could affect earnings.

Valuation (Consolidated) Rs cr

Particulars	FY2021	FY2022E	FY2023E	FY2024E
Net sales	15,102.2	15,621.6	17,031.6	19,078.4
Operating Profit	3,341.0	3,455.7	3,880.1	4,584.8
OPM (%)	22.1	22.1	22.8	24.0
Adjusted Net profit	2,291.3	2,166.4	2,516.9	2,956.9
EPS (Rs)	22.4	21.2	24.6	28.9
PER (x)	16.5	17.4	15.0	12.8
EV/EBITDA (x)	12.8	11.7	9.9	7.9
P/BV (x)	2.9	2.6	2.3	2.0
RoCE (%)	12.8	13.7	14.4	15.6
RoNW(%)	17.6	14.9	15.3	15.7

Source: Company; Sharekhan estimates

Outlook and Valuation

- **Sector View: Growth momentum to improve:** Indian pharmaceutical companies are better-placed to harness opportunities and register healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in the US generics market), a rise in product approvals, and plant resolutions by the USFDA coupled with strong growth prospects in domestic markets and emerging opportunities in the API space would be key growth drivers. This would be complemented by strong capabilities developed by Indian companies (leading to a shift towards complex molecules and biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharmaceutical companies.

- **Company Outlook – Healthy growth outlook:** Over the long term, both geographies – US and India have an healthy growth outlook. The US, which accounts for close to almost half its revenue, is on a strong footing helped by a sturdy new product pipeline and ramp-up in recent product launches, which would be long term growth drivers. However, in the near term high price erosion would act as dampeners. The efforts to build-up a presence in the injectables space would also add to growth albeit over the medium to long term. The India business has a robust growth outlook backed by a pickup in the chronic as well as acute therapies and a few substantial high value launches lined up. Over the long term, product launches such as Saroglitazar, gRevlimid and Desidustat offer substantial growth potential. Further, opportunities from the COVID-19 vaccine are also material and provide a visibility on growth. With substantial reduction in debt, the company has strengthened its balance sheet. The management looks to keep an eye on debt reduction going ahead as well. This augurs well and would go towards strengthening the financial muscle of the company. Strong earnings prospects, healthy return ratios, and strengthening balance sheet are key positives. While in the near term, US growth is expected to moderate while India and other geographies are likely to stage double digit growth.

- **Valuation – Retain Buy with Revised PT of Rs 480:** Zydus Lifesciences' sees the pricing pressures in the US to sustain while delayed re-inspection for the Moraiya could also act a dampener. Hence the US growth is expected to moderate in FY23 while the same is expected to bounce back impressively in FY24 with the management expecting a $1bn revenues from US. On the other hand, the India business backed by growth in the existing business and new product launches is expected to stage a double-digit growth in FY23. Further though the Covid vaccines opportunities has moderated, the management is exploring opportunities in the exports markets and sees a healthy traction in the subsequent quarters. Over the long term, IP-driven products and specialty products provide sizeable growth opportunities. At CMP, the stock trades at 17.4x/15x/12.8x its FY22E/FY23E and FY24E. The stock price has corrected by ~33% in the past six months and the valuations now look reasonable. Basis the expected strong outlook for the India business and other Emerging Markets we retain Buy recommendation on the stock with revised PT of Rs. 480.

One-year forward P/E (x) band

Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Zydus Lifescience	369.0	102.4	37,801.0	16.5	17.4	15.0	12.8	11.7	9.9	17.6	14.9	15.3
Lupin	785	45.3	35,658	29.3	26.7	22.3	15.5	12.2	9.9	8.8	9.0	9.9
Dr Reddy's	4,317.0	16.6	71,835.0	36.7	26.0	19.2	14.5	13.5	10.5	11.1	14.4	17.5

Source: Company, Sharekhan estimates

About company

Zydus Lifesciences is one of the leading pharmaceutical companies in India. The company is present across the pharmaceutical value chain of research, development, manufacturing, marketing, and selling of finished dosage human formulations (generics, branded generics, and specialty formulations, including biosimilars and vaccines), active pharmaceutical ingredients (APIs), animal healthcare products, and consumer wellness products. The company has a global presence and sells its products in the US, India, Europe, and emerging markets, including countries in Latin America, Asia Pacific region, and Africa. The company is also engaged in research and development activities focused across the value chain of API process development, generics development for simple as well as differentiated dosage forms such as modified release oral solids, transdermal, topicals and nasals, biologics, vaccines, and new chemical entities (NCE).

Investment theme

Zydus Lifesciences is favourably progressing in its efforts to build an alternative growth platform (NCE, biologics, and vaccines) that should start delivering over the medium to long-term and reduce the company's dependence on limited competition assets in the US for its earnings. India business including the consumer wellness segment is likely to grow at a healthy pace, albeit over the medium to long term. It is in a sweet spot, wherein both its geographies have an improved growth outlook. Easing pricing pressures, sturdy new product pipeline, and ramp-up in the recent product launches would be key growth drivers for the US business. The efforts to build up presence in the injectables space would also add to growth albeit over the medium to long term. India business is also showing signs of pick-up in growth momentum, led by solid presence in the chronic and sub-chronic segments and an improving outlook for the acute segment. Further, COVID-19 related opportunities would add to the growth momentum.

Key Risks

1) Regulatory compliance risk; 2) delay in product approvals; 3) currency risk;and 4) concentration risk in the US portfolio.

Additional Data

Key management personnel

Pankaj R. Patel	Chairman
Dr. Sharvil P. Patel	Managing Director
Mr. Ganesh Nayak	COO & Executive Director
Mr. Nitin Parekh	CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	3.3
2	Kotak Mahindra Asset Management Co	2.24
3	GOVERNMENT PENSION FUND - GLOBAL	1.18
4	Norges Bank	1.18
5	UTI Asset Management Co	0.83
6	Vangaurd Group	0.75
7	Nippon Life Asset Management	0.68
8	Franklin resources	0.48
9	Fund Rock Management	0.46
10	ICICI Prudential Asset Management	0.37

Source: Bloomberg; Updated - 27 May 2021

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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