Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Zydus Lifesciences Ltd

Steady Q4; US bizz to be stressed in the near term; India outlook healthy

Pharmaceuticals	Sharekhan code: ZYDUSLIFE

Reco/View: Buy	↔	CMP: **Rs. 357**	Price Target: **Rs. 440**	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We retain our Buy Recommendation on Zydus Lifesciences Limited (Zydus) with a revised PT of Rs. 440.
- Zydus reported steady operating performance for Q4FY2022, adjusting for the inventory provisioning related to Covid products and results were ahead of estimates.
- Zydus's US business has a healthy growth outlook over the long term, supported by a strong pipeline of new products, though headwinds in the form of slow product/plant approvals and pricing pressures would play dampeners in the near term.
- Growth prospects in India as well as emerging markets stay bright and management looks to outpace the industry's growth in India business.

Zydus Lifesciences Limited (Zydus) reported a steady operating performance for Q4FY2022, adjusting for inventory provisioning related to Covid products and results were ahead of estimates. Revenue at Rs. 3,684 crore grew by 5% y-o-y, backed by 11% y-o-y growth in the domestic business, while exports were almost flat. Adjusting for inventory provisioning of Rs.143 crore, operating profit margin (OPM) stood at 22.3%, down 90 bps y-o-y and adjusted EBITDA stood at Rs 860.7 crore, up 1.3% y-o-y and was ahead of estimates. Going ahead, management sees healthy growth prospects for India and emerging markets, while US business is expected to be under stress in the near term. Over the long term, prospects are bright, driven by growth from IP-driven products and biosimilars. Near-term growth is expected to be slow for the US impacted by price erosion and heightened cost inflationary pressures.

Key positives

- Excluding Covid products, India formulations business reported strong 19% y-o-y growth.
- Emerging market formulations business grew by 10% because of healthy growth in LATAM countries.

Key negatives

- US sales declined by 4.3% y-o-y because of pricing pressures, while API sales declined by 2.3% y-o-y.
- Delay in Moraiya plant inspection by USFDA
- Management expects pricing pressures to sustain in US markets.

Management Commentary

- Management expects India business to outpace the industry's growth, backed by market share gains in key therapy areas, new launches, focus on brand building, and growth in the base business.
- US business growth is expected to be impacted by high price erosion, which is expected to sustain and management expects US sales to grow in single digits for FY2023. However, strong product pipeline for the US, including specialty and injectables, would be long-term drivers.
- The company has recently received an approval for a two-dose regimen of covid vaccine Zycov-D; however, given lower infections, demand in domestic markets has reduced. Hence, the company is evaluating opportunities in exports markets.

Revision in estimates – Q4FY2022 was a steady quarter. Adjusting for inventory provisioning related to Covid products, OPM stood at 22.3%, down 90 bps y-o-y. Factoring in the near term likely cost pressures and uncertainties for the US business, we have revised downwards our estimates for FY2023E/FY2024E.

Our Call

Valuation: Retain Buy with a revised PT of Rs. 440: Zydus's growth prospect in India as well as in emerging markets stay bright, while that in US markets is likely to moderate in the near term due to heightened pricing pressures. Further, the vaccine opportunity in domestic markets has moderated. Given sustained cost pressures, the company has guided for EBITDA margin of 20% for FY2023E, lower than 21.9% reported in FY2022. At the CMP, the stock trades at 17.1x/14.7x its FY2023E/FY2024E EPS. Based on the expected healthy outlook for India business and other emerging markets, we retain our Buy recommendation on the stock with a revised price target (PT) of Rs. 440.

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	FY2022	FY2023E	FY2024E
Net sales	14,403.5	15,265.2	16,472.7	18,015.4
Operating Profit	3,387.1	3,340.7	3,432.4	3,874.0
OPM (%)	23.5	21.9	20.8	21.5
Net profit	2,359.3	2,082.7	2,141.7	2,484.3
EPS (Rs.)	23.0	20.3	20.9	24.3
PER (x)	15.5	17.6	17.1	14.7
EV/EBITDA (x)	12.2	11.9	11.1	9.3
P/BV (x)	2.8	2.2	2.0	1.8
RoCE (%)	13.3	12.2	11.3	12.0
RoNW(%)	18.2	12.3	11.5	12.2

Source: Company; Sharekhan estimates

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. 36,563 cr
52-week high/low:	Rs. 669 / 319
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	-0.9	-3.8	-21.7	-41.9
Relative to Sensex	3.9	2.3	-12.8	-51.5

Sharekhan Research, Bloomberg

Strong Q4, adjusting for one-offs results, ahead of estimates: Zydus reported a steady operating performance for Q4FY2022, adjusting for inventory provisioning related to Covid products and results were ahead of estimates. Revenue at Rs. 3,684 crore grew 5% y-o-y, backed by 11% y-o-y growth in the domestic business, while exports were almost flat, declining by 0.7% y-o-y and the revenue was largely in line with estimates. During Q4, the company had taken a provision amounting to Rs. 143 crore for Covid-related inventory; and adjusting for this, OPM stood at 22.3%, down 90 bps y-o-y due to a 130-bps y-o-y gross margin contraction on account of cost pressures and mix change. Adjusted EBITDA stood at Rs. 860.7 crore, up 1.3% y-o-y and was ahead of estimates. Interest cost for Q4 was up 66% y-o-y and the company reported tax outgo as against tax credit for Q4FY2021. Consequently, adjusted PAT stood at Rs. 555 crore, down 28% y-o-y, ahead of estimates.

Q4FY2022 Conference Call Highlights

- **Strong new launch pipeline to fuel US bizz growth over the long term, near-term growth likely to moderate:** US sales declined by 4% y-o-y/5.3% q-o-q to Rs. 1,423 crore. During Q4FY2022, Zydus witnessed heightened competitive intensity in US markets and this resulted in elevated price erosion. Going ahead, over the long term, the company sees healthy outlook for the US. Growth would be backed by strong product launch pipeline, which would include new chemical entities (NCEs) and specialty products including injectables to be launched over the next two years. During Q4, the company has launched four new products in US markets and has lined two high-value products to be launched in US markets in 2HFY2023. Further, over the next one year, Zydus has lined up 2-3 potential high-value launches in US markets, which provide ample growth visibility. Moreover, in Q4, the company has filed for one ANDA and has received five new product approvals. Moreover, the company has entered into an asset purchase agreement for the acquisition of NULIBRY injection. Further, in the past, Zydus has launched a sizeable new product portfolio in US markets, which are expected to ramp up going ahead and would aid topline growth. The company has also lined up biosimilars to be launched in US markets, though time lines are not known and are likely to be in or beyond FY2024. Cumulatively, a strong product pipeline would enable Zydus to offset the effect of price erosion, albeit substantial high-value product launches are likely over the long term with material growth expected in FY2024. The company expects growth in the US to be in single digit for FY2023, given near-term headwinds in the form of price erosion, which is in mid to high single digits and could sustain.

- **Emphasis on sizeable specialty/injectables franchise bodes well and could fuel growth:** Zydus is looking to grow its complex injectables portfolio over the next 3-4 years. Zydus is in for clinical trials for Saroglitazar MG (Orphan Drug Designation from USFDA) for two indications – Primary Biliary Cholangitis (PBC) and NASH and expects Saroglitzar MG to be launched for PBC in the US by 2025, while that for NASH indication is expected to be by 2027. In addition to this, Cadila has submitted NDA to DCGI for Desidustat for treatment of anaemia in patients with CKD. In addition to this, there are two other NCEs (ZY19489 and ZYIL1), which are in the pipeline. Apart for NCEs, it is also building a pipeline of biosimilars with pegfilgrastim getting approved in Russia and gradually being expanded to other geographies. Overall, in the next three years, the company expects 3-4 biosimilars to come up for approval, which could fuel growth. Moreover, Zydus has commenced rolling submission for its specialty product CUTX-101 and is expecting an approval for a module soon. In addition to this, it has a slew of products in various stages in the specialty segment/505 (b) (2) route, which has significant growth potential. In the long term, focus on IP-driven products and focus on injectables could be the key growth drivers for Zydus.

- **Robust outlook for domestic formulation business, backed by new launches:** Zydus's domestic business recorded double-digit growth of 11% y-o-y for Q4 due to 13.8% y-o-y growth in domestic formulations, while the wellness business grew by 6% y-o-y. The branded prescription business has staged strong 14% growth, primarily driven by volume expansion. Going ahead, the domestic formulations business is expected to sustain the strong growth traction and the company expects to outpace the industry's growth. This would be driven by a higher momentum in overall base business across chronic and sub-chronic therapies and focus on brand building. In addition, the company has gained market share in anti-diabetic, and cardiovascular therapeutic areas, which is expected to sustain ahead as well. Further, Cadila has launched Desidustat in Indian markets in March 2022, which is a high-value launch and the company is targeting for healthy conversion of new as well as existing patients, which is positive. The company's strong brand position and well-spread distribution reach and broadening of the product portfolio would be key growth drivers for India business and management aims to outpace the industry's growth.

- **COVID Vaccine updates:** Zydus Lifesciences COVID-19 vaccine ZyCoV-D has received an Emergency Use Approval from the regulators for India. Approval was received for the adolescents in 12-18 years age group as well besides the adult population. Recently the company has also received an approval for the two-dose regiment for the vaccine, however due to the lower infections, the demand for the covid vaccines has almost waned away in the India markets, however the opportunity still exists in the exports markets and the company is the fray to tap the exports for the Zycov-D.
- **Regulatory aspects:** Zydus has completed all CAPAs and has submitted its responses to the USFDA, which have been accepted by the agency. A revert from the regulator is awaited. Regulatory clearance for Moraiya plant could be a key growth driver for the company; and once approved, management would be in a position to go ahead with the transdermal patches portfolio launch in the US, which are filed from Moraiya.
- **Outlook:** Backed by a strong outlook, management sees India business to outpace the industry's growth, while US revenue is expected to report modest single-digit growth in FY2023. Sustained pricing pressures and delayed new product launches would slow down growth for the US. Further, sustained pricing pressures and higher costs are likely to impact the margin trajectory and management has guided for EBITDA margin at around 20%, which is lower as compared to 21.9% reported in FY2022.

Results (Standalone) Rs cr

Particulars	Q4FY2022	Q4FY2021	YoY %	Q3FY2022	QoQ%
Total operating revenue	3,863.8	3,670.3	5.3	3,639.9	6.2
Operating profit	860.7	849.5	1.3	751.7	14.5
Other Income	79.1	-30.4	-360.2	60.7	30.3
EBITDA	939.8	819.1	14.7	812.4	15.7
Interest	38.5	23.2	65.9	31.1	23.8
Depreciation	185.4	175.3	5.8	177.0	4.7
PBT	715.9	620.6	15.4	604.3	18.5
Taxes	109.2	-206.0	-153.0	110.7	-1.4
PAT	606.7	826.6	-26.6	493.6	22.9
Adjusted PAT	555.4	774.0	-28.2	505.7	9.8
Margins			**BPS**		**BPS**
OPM %	22.3	23.1	-86.9	20.7	162.4
PATM %	14.4	21.1	-671.4	13.9	48.1
Tax rate %	15.3	-33.2	4,845	18.3	-306.5

Source: Company, Sharekhan Research; Q4FY22 numbers adjusted for provision of Rs 143 cr for Covid related inventory

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), 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.

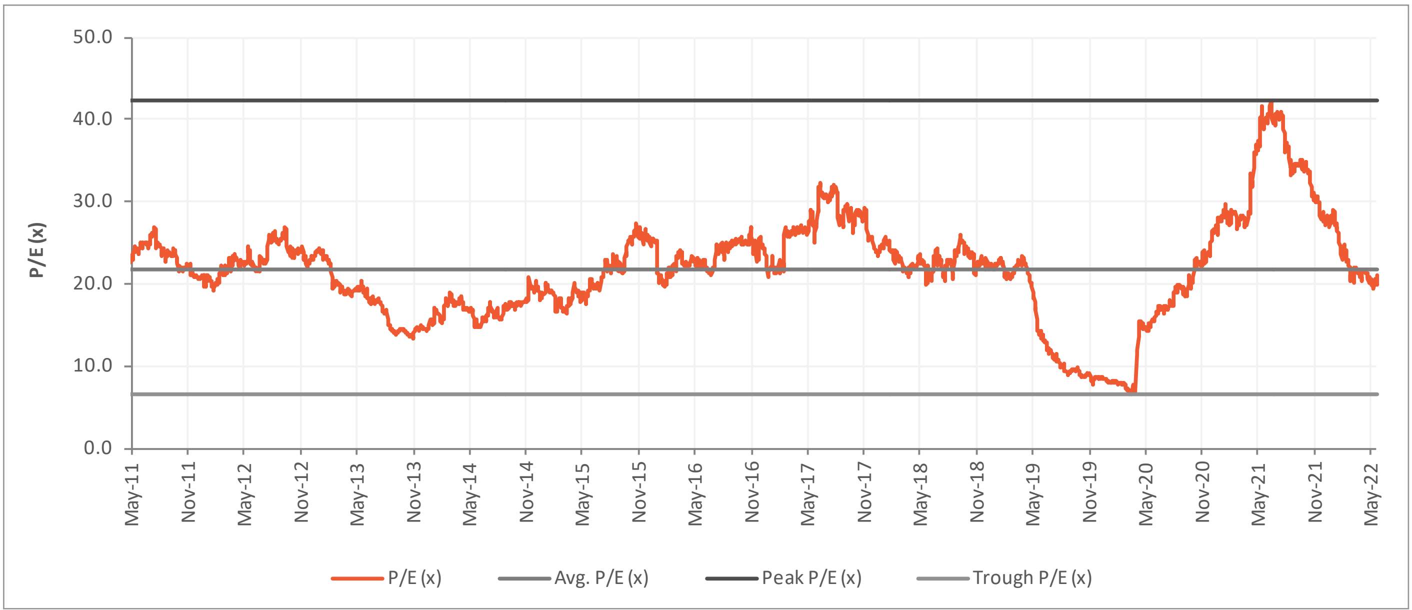
Company Outlook – Healthy growth outlook: Over the long term

Both geographies – US and India – have a 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 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 pickup in 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 growth visibility. With substantial reduction in debt, Cadila has strengthened its balance sheet. Management looks to keep an eye on debt reduction going ahead as well. This augurs well and would go towards strengthening the company's financial muscle. Strong earnings prospects, healthy return ratios, and strengthening balance sheet are key positives for Cadila. 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. 440

Zydus sees pricing pressures in the US to sustain while delayed re-inspection for Moraiya plant leading to slower new launch momentum could act a near-term dampener. Cadila sees US growth to moderate in FY2023 and could improve in FY2024, driven by expected new launches. On the other hand, India business, backed by growth in the existing business and new product launches, is expected to outpace the industry's growth. Further, although Covid vaccine's opportunities have moderated, management is exploring opportunities in exports markets. Over the long term, IP-driven products and specialty products provide sizeable growth opportunities. Q4FY2022 was a steady quarter and, adjusting for inventory provisioning related to Covid products, OPM stood at 22.3%, down 90 bps y-o-y due to gross margin contraction, but results were ahead of estimates. Factoring in near-term likely cost pressures and uncertainties for the US business, we have revised downwards our estimates for FY2023E/FY2024E. At the CMP, the stock trades at 17.1x/14.7x its FY2023E/FY2024E EPS. Based on the expected healthy outlook for India business and other emerging markets, we retain our Buy recommendation on the stock with a revised PT of Rs. 440.

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 (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Zydus Lifescience	357.0	102.4	36,563.0	17.6	17.1	14.7	11.9	11.1	9.3	12.3	11.5	12.2
Cipla	979.0	80.6	78954.0	28.8	25.7	20.3	17.1	15.5	12.4	14.6	13.8	15.3
Dr Reddy's	4,246.0	16.6	70,665.0	32.3	20.0	17.6	13.2	10.7	9.0	11.4	16.9	16.8

Source: Company, Sharekhan estimates

About company

Zydus Lifescience 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 Lifescience 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. Cadila 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) risk concentration 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

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;