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Stock Update

Company Update

Zydus Lifesciences Ltd

Strong product launches improve decent earnings growth visibility

Pharmaceuticals	Sharekhan code: ZYDUSLIFE

Reco/View: Buy	↔	CMP: **Rs. 448**	Price Target: **Rs. 563**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

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 38.30

Updated May 20, 2022

High Risk

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

Source: Morningstar

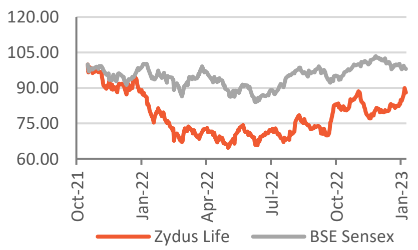
Company details

Market cap:	Rs. 45,361 cr
52-week high/low:	Rs. 459 / 319
NSE volume: (No of shares)	15.5 lakh
BSE code:	532321
NSE code:	ZYDUSLIFE
Free float: (No of shares)	25.6 cr

Shareholding (%)

Promoters	75.0
FII	2.5
DII	13.7
Others	8.81

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	10.4	6.6	21.8	1.1
Relative to Sensex	14.5	2.5	9.8	3.2

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy rating on Zydus Lifesciences to Buy and increase the stock's PT to Rs. 563 (vs. earlier Rs. 440), as we foresee decent margin expansion and, therefore, estimate the company's earnings to grow at an 11.5% CAGR during FY2022-FY2025E.
- Strong volume growth in the recently launched key products and new products to be launched in the US in Q3FY2023E should lead to equally strong growth in the US market for the upcoming quarters.
- The company's India market is also expected to grow at a strong pace with market share gains in key therapies.
- Strong ramp-up in its key products' share in the US and India is likely to enhance its adjusted EBITDA margin, as it indicates a healthy product mix.

Zydus Lifesciences has been seeing strong ramp-up in its key products in the US, which have a market opportunity of $2.0-2.5 billion on an annual basis. Moreover, clearance given by the USFDA to its Moraiya facility should accelerate the pace of product launches in the US. Secondly, the company has been seeing decent market share gains in its key therapies in the Indian Pharma Market (IPM). The consumer wellness business is also expected to improve its gross margins in the coming quarters. Moreover, the company has been witnessing cost pressure dissipate over a period. All these factors indicate decent product ramp-up and margin expansion with improved product mix and easing of cost pressures.

- **US outlook strong with market share gains in key products:** Some of the company's key products such as gAsacol HD (marginal decline q-o-q), gLacosamide injection, and gAlimta (Pemetrexed Disodium) have seen strong volume expansion in Q3FY2023E on a sequential basis. The company has also launched the blockbuster drug, gRevlimid, in Q2FY2023. Strong volume growth in recently launched key products and new products to be launched in Q3FY23E should lead to equally strong growth in the US market going ahead.
- **Indian market growing strong with market share gains:** The company has been gaining market share in key therapies such as cardiovascular, gynecology, respiratory, and gastrointestinal in the IPM.
- **Strong and key product launches leading to margin improvement:** The company's EBITDA margin excluding COVID-19 inventory write-offs expanded to 22.6% in Q2FY2023 vs. 20.6% in Q2FY2022. The company expects to report 20% EBITDA margin at least for FY2023, in line with increased product approvals and key launches.

Our Call

Valuation – Zydus Lifesciences has been seeing strong volume gains in its key products in the US in Q3FY23E, which are blockbuster drugs with sales potential of over $2.0-2.5 billion on an annual basis. Additionally, it is expected to witness strong traction in new product launches with its Moraiya facility being cleared by the USFDA recently. The company's India market is also expected to grow at a strong pace with market share gains in key therapies. The company is experiencing a strong ramp-up in its key products' share in the US and India, which is enhancing its adjusted EBITDA margin, as it indicates a healthy product mix. We introduce FY2025E estimates and roll forward our valuation to FY2025. We expect the company to register revenue and earnings CAGR of 8.9% and 11.5%, respectively, over FY2022-FY2025E. The stock is trading at 17.9x/15.9x its FY2024/FY2025 EPS estimates. We apply a PE of 20.0x on its FY2025 EPS and arrive at a price target (PT) of Rs. 563, indicating an upside of 26%. Thus, we maintain our Buy rating on the company.

Key Risks

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

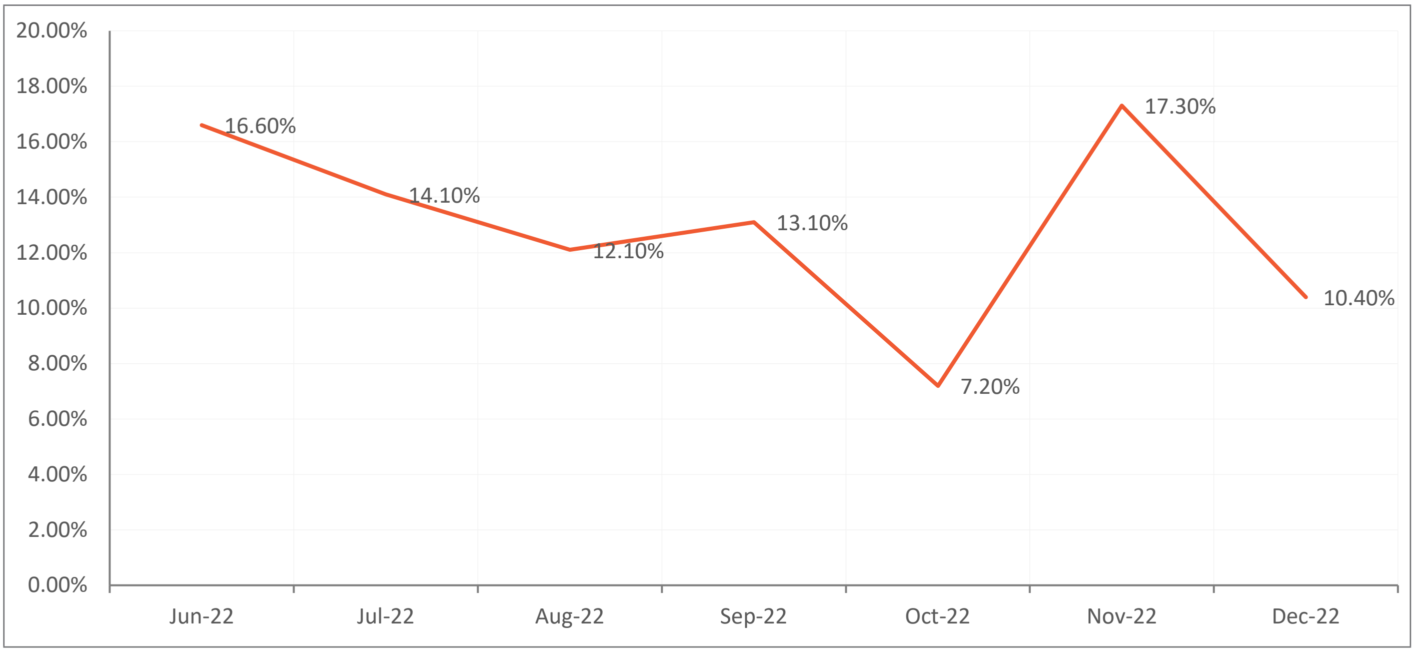
Valuation (Consolidated) Rs cr

Particulars	FY2021	FY2022	FY2023E	FY2024E	FY2025E
Net sales	14,403.5	15,265.2	16,472.7	18,015.4	19,718.9
EBITDA Margin (%)	23.8	23.4	22.1	22.7	22.8
Adj. PAT	2,359.3	2,082.7	2,215.8	2,566.7	2,884.3
Adj. EPS (Rs.)	23.0	20.3	21.6	25.1	28.2
PER (x)	19.5	22.0	20.7	17.9	15.9
EV/EBITDA (x)	15.0	14.7	13.7	11.6	9.9
ROCE (%)	13.3	12.2	11.7	12.4	12.6
RONW (%)	18.2	12.3	11.9	12.5	12.6

Source: Company; Sharekhan estimates

- **US outlook strong with market share gains in key products:** Volumes of gAsacol HD (mesalamine), in which the company has a leadership position in the US market with over 98% market share, have declined at a slower pace of 2.0% q-o-q in Q3FY2023E. The company has been planning to launch other variants of mesalamine such as gPentasa as well, which will help it defend its market leadership in the drug. Moreover, the company's newly launched gLacosamide injection's market share has grown to 25.4% in Q3FY23E from 8.6% in Q2FY23, as gLacosamide's volumes have grown at a strong pace of 94% q-o-q in Q3FY2023E. Similarly, Zydus was able to achieve 30% q-o-q growth in gAlimta (Pemetrexed Disodium) in Q3FY2023E, which was launched in Q1FY2023. The company has launched the blockbuster drug, gRevlimid, also in Q2FY2023. These key products together represent around $2.0 - 2.5 billion of annual sales opportunity in the US. The company launched 10 new products and has received approval for 15 new products including two tentative approvals in Q2FY2023. The company is also looking to launch four transdermal products in the near term and Trokendi XR FTF in Q4FY2023. Strong volume growth in the recently launched key products and new products to be launched in Q3FY2023E should lead to equally strong growth in the US market going ahead. The company's US revenue increased by 14% y-o-y (+9.6% q-o-q) to Rs. 1,708.4 crore in Q2FY2023.
- **India market growing strong with market share gains in its key therapies:** The company's India formulations business increased by 4.3% y-o-y (+12.4% q-o-q, 32% of revenue) including COVID-19 related revenue in the base quarter of Q2FY2022, while the consumer business continued to post double-digit growth, growing by 12.1% y-o-y (-38.9% q-o-q, 10.7% of revenue). The y-o-y growth was driven by market share gains in key therapies such as cardiovascular, gynecology, respiratory, and gastrointestinal. The company's Lipaglyn (anti-diabetic drug) increased its ranking by 10 positions in IPM from 66th position as of Q1FY2023 to 56th position as of Q2FY2023. The consumer business was driven by Glucon-D, Nycil, and Everyuth brands. However, gross margin was under pressure in the consumer business due to increased key inputs costs. The company has been taking price hikes to be able to mitigate any gross margin pressures.
- **Strong key product launches leading to margin improvement:** In Q2FY2023, the company posted 9.2% y-o-y (+1.5% q-o-q) rise in operating income to Rs. 4,135 crore. It was driven by strong growth witnessed in India business, including consumer wellness and the US markets. The company's EBITDA margin, excluding COVID-19 inventory write-offs, expanded to 22.6% in Q2FY2023 vs. 20.6% in Q2FY2022. The company expects to register 20% EBITDA margin, at least for FY2023, in line with increased product approvals and key launches. The company has seen its Moraiya plant being cleared by the USFDA recently, which will enable it to see accelerated product approvals in the US.

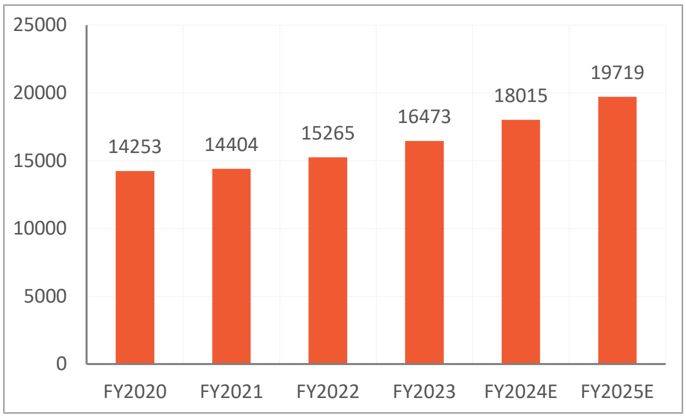
IPM Growth YoY



Source: India Ratings, AIOCD

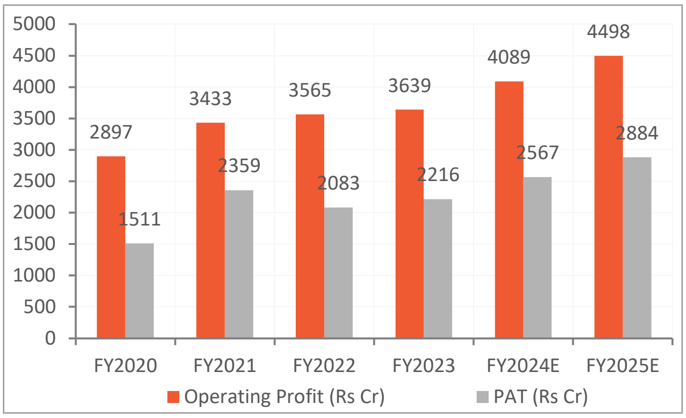
Financials in charts

Sales Trends (Rs Cr)



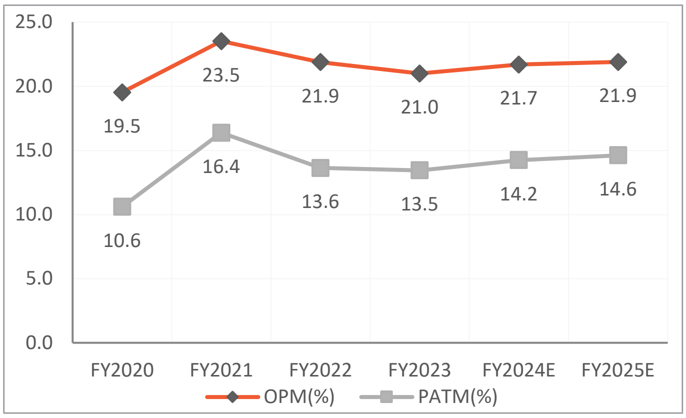
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



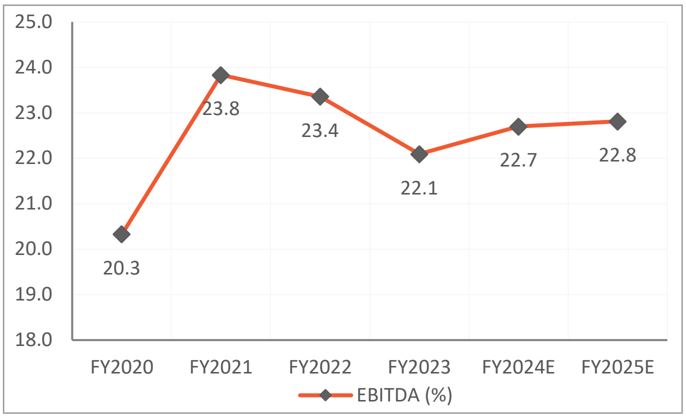
Source: Company, Sharekhan Research

Margins



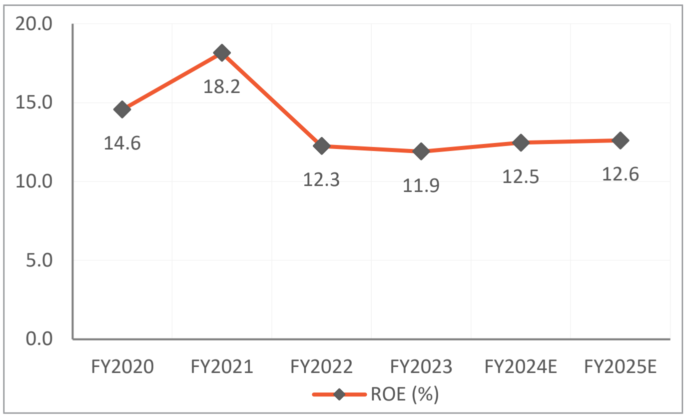
Source: Company, Sharekhan Research

EBITDA margin Trend (%)



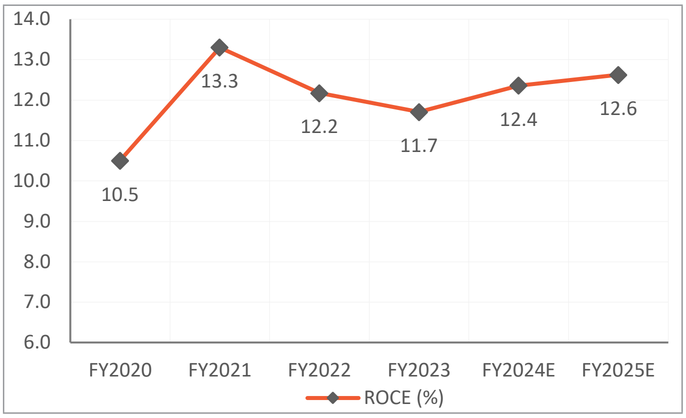
Source: Company, Sharekhan Research

RoE Trends (%)



Source: Company, Sharekhan Research

ROCE Trends (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Multiple growth engines ahead

The IPM is growing with increased consumer spend and awareness. Additionally, Indian pharmaceutical players with a large market share in IPM and a strong pipeline of specialty products will help them gain market share in the US, thereby partially offsetting any impact of competitive pricing pressure in the US. Moreover, other factors such as faster product approvals and resolutions by the USFDA regards to plant observations and 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, biosimilars, and injectables) and the commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for Indian pharma companies.

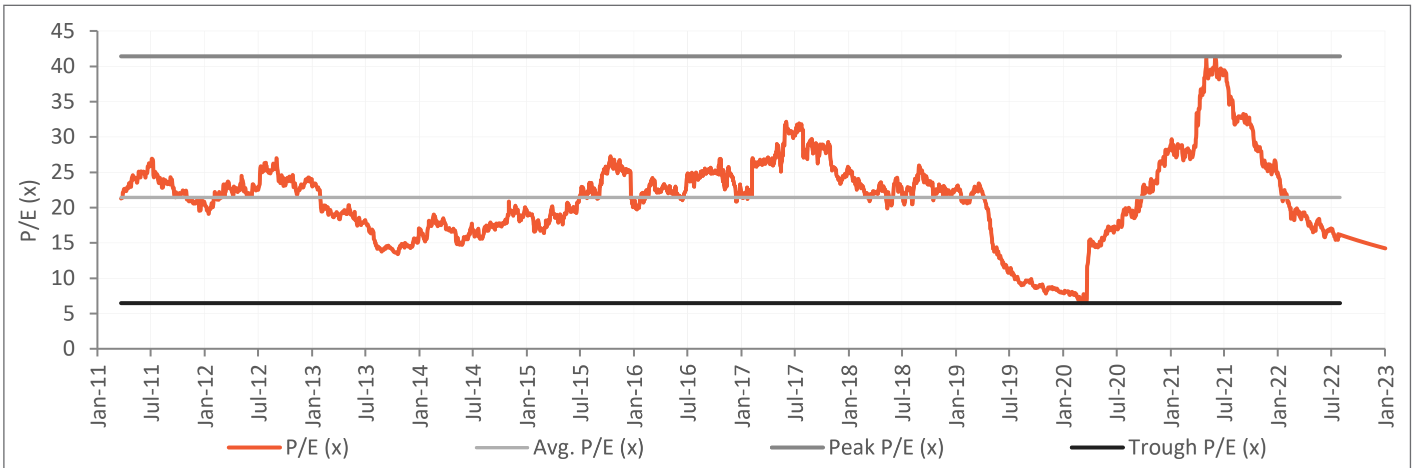
■ Company Outlook – Healthy growth outlook:

Over the long term, both geographies – US and India – have a healthy growth outlook. The US business 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 a dampener. The efforts to build up presence in the injectables space would also add to growth, albeit over the medium to long term. India business has a robust growth outlook, backed by pick-up 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. With substantial reduction in debt, Zydus Lifesciences 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 a strengthening balance sheet are key positives for Zydus Life sciences. In the near term, US growth is expected to moderate, while India and other geographies are likely to stage double-digit growth.

■ Valuation – Maintained Buy with an increased PT of Rs. 563

Zydus Lifesciences has been seeing strong volume gains in its key products in the US in Q3FY23E, which are blockbuster drugs with sales potential of over $2.0-2.5 billion on an annual basis. Additionally, it is expected to witness strong traction in new product launches with its Moraiya facility being cleared by the USFDA recently. The company's India market is also expected to grow at a strong pace with market share gains in key therapies. The company is experiencing a strong ramp-up in its key products' share in the US and India, which is enhancing its adjusted EBITDA margin, as it indicates a healthy product mix. We introduce FY2025E estimates and roll forward our valuation to FY2025. We expect the company to register revenue and earnings CAGR of 8.9% and 11.5%, respectively, over FY2022-FY2025E. The stock is trading at 17.9x/15.9x its FY2024/FY2025 EPS estimates. We apply a PE of 20.0x on its FY2025 EPS and arrive at a PT of Rs. 563, indicating an upside of 26%. Thus, we maintain our Buy rating on the company.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBITDA (x)			RoE (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Zydus Lifescience	448.2	101.2	45,352.8	22.0	20.7	17.9	14.7	13.7	11.6	12.3	11.9	12.5
Cipla	1061.2	80.6	85,649.0	33.7	29.2	23.3	20.1	17.8	14.4	14.6	14.2	15.5
Dr Reddy's	4,310.6	16.6	71,781.0	32.8	19.8	16.2	13.5	11.1	9.4	11.4	17.3	18.5

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. Zydus Lifesciences 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 a pick-up in growth momentum, led by a 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 company's 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	3.30
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

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Compliance Officer: Ms. Binkle Oza; Tel: 022-61150000; email id: complianceofficer@sharekhan.com;

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

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