Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Zydus Lifesciences Ltd

Q3 Strong beat; healthy growth outlook

Pharmaceuticals	Sharekhan code: ZYDUSLIFE
Reco/View: Buy ⇔	CMP: **Rs. 435**
	Price Target: **Rs. 572** ↑

↑ Upgrade ⇔ Maintain ↓ Downgrade

Summary

- For Q3FY23, a better product mix drove up profits strongly. Revenue grew at 19.8% y-o-y to Rs. 4,362 crore (versus internal and street estimates of Rs. 4,123 crore and Rs. 4,151 crore.) and net profits grew at 23.1% y-o-y to Rs. 622.5 crore (versus internal and street estimates of Rs. 571 crore and Rs. 564 crore).
- The company is expected to maintain the growth momentum on the back of key product launches in the US and India.
- The company envisions to continue to outperform Industry growth in its key therapies in India. Lipaglyn, the first such NCE from India, is improving its IPM rank.
- We maintain a Buy on Zydus Lifesciences and revise its PT to Rs. 572 (Rs. 563 earlier). The stock is trading at an attractive valuation of 16.9x and 15.2x its FY2024E and FY2025E estimates.

Zydus Lifesciences outperformed in Q3FY2023 on the profitability front, largely driven by strong growth in revenue and gross margins, indicating improved products mix on the back of key product launches in the US and India. Revenues at Rs. 4,362 crore increased by 19.8% y-o-y and was higher than our and average street expectation of Rs. 4,123-4,151 crore. EBITDA margins at 21.9%, expanded by 126 bps y-o-y (versus internal estimate of 21.5%), led by a 201-bps y-o-y expansion in the gross margins to 65.4%. Strong revenues growth and a rise in the margins led to a strong 23.1% y-o-y rise in the reported PAT to Rs. 622.5 crore (versus internal estimate of Rs. 571 crore and street estimate of Rs. 564 crore).

Key positives

- Strong beat on profitability front
- Introduced Estradiol Transdermal System (twice weekly) product, first one, from its Moraiya facility after it has been cleared by the USFDA, recently. It expects to launch nearly 3 such products in the near term.
- It is expected to launch 1-2 partnered products in injectables space in CY2023.

Management Commentary

- The company expects R&D investments to be at 7-8% of sales in FY2023. However, it is expected to be 8-9% of sales over medium – long term.
- R&D on generic is expected to remain stable while it will be more on NCEs and biosimilars, which is likely to gradually scale up.
- Specialty products form 30% of total R&D spend towards clinical programs while the specialty R&D spend is likely to go up as a percentage of the R&D spend, gradually.
- The company envisions to continue to outperform Industry growth in its key therapies. Lipaglyn, the first such NCE from India, is improving its IPM rank.

Revision in estimates – Key products are expected to be launched faster now, given the USFDA clearance for its Moraiya facility. Also, its India business is expected to continue to grow at a strong pace driven by strong product launches and its focus on growing above industry growth rate. Hence, we revise upwards its sales and earnings estimates to CAGR of 10.1% and 12.0% versus 8.9% and 11.5%, earlier, respectively, over FY2022-FY2025E.

Our Call

Valuation – Retain Buy with a changed PT of Rs. 572: Zydus Lifesciences has been witnessing strong sales growth in India and the US on the back of strong product launches. Additionally, as expected it has introduced the *Estradiol Transdermal System* (twice weekly) product, first one, from its Moraiya facility after it has been cleared by the USFDA, recently. It expects to launch nearly 3 such products in the near term. The company's India business 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 expect the company to register revenue and earnings CAGR of 10.1% and 12.0% (versus 8.9% and 11.5%, earlier, respectively, over FY2022-FY2025E). The stock is trading at a reasonable valuation of 16.9x/15.2x its FY2024/FY2025 EPS estimates. We continue to apply a PE of 20.0x on its revised FY2025 EPS and arrive at a price target (PT) of Rs. 572 (Rs. 563), indicating an upside of 32%. Thus, we maintain our Buy rating on the company.

Key Risks

1) Price erosion in the US generics business could hurt performance. 2) Forex volatility could affect earnings.

Valuation (Consolidated) Rs cr

Particulars	FY2021	FY2022	FY2023E	FY2024E	FY2025E
Net sales	14,403.5	15,265.2	16,990.2	18,600.2	20,371.4
EBITDA	3,432.7	3,565.4	3,962.5	4,316.7	4,706.4
OPM (%)	23.8	23.4	23.3	23.2	23.1
Adjusted Net profit	2,359.3	2,082.7	2,373.5	2,636.9	2,928.0
EPS (Rs)	23.0	20.3	23.2	25.8	28.6
PER (x)	18.9	21.4	18.8	16.9	15.2
EV/EBITDA (x)	14.6	14.3	12.4	10.8	9.2
P/BV (x)	3.4	2.6	2.4	2.1	1.9
RoCE (%)	13.3	12.2	13.0	13.2	13.3
RoNW (%)	18.2	12.3	12.6	12.7	12.6

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 38.30

Updated Dec 08, 2022

High Risk

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

Source: Morningstar

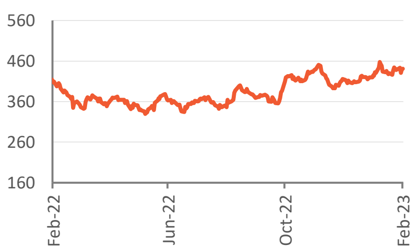
Company details

Market cap:	Rs. 43,995 cr
52-week high/low:	Rs. 459 / 319
NSE volume: (No of shares)	14.6 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	0.4
Relative to Sensex	14.5	2.5	9.8	2.4

Sharekhan Research, Bloomberg

Strong beat on profitability in Q3

Zydus Lifesciences posted a strong beat on EBITDA and reported PAT in Q3FY2023. The company posted a 19.8% y-o-y rise in revenue to Rs. 4,362 crore (versus internal estimate of Rs. 4,121 crore and street estimate of Rs. 4,151 crore), driven by strong growth across markets, especially in the US and India. While the US formulations revenue grew at 27.2% y-o-y, India revenue clocked in strong growth at 13.9% y-o-y. EBITDA grew at a strong pace of 27.2% y-o-y to Rs. 956 crore (versus internal estimate of Rs. 886.2 crore and street estimate of Rs. 866 crore), as the gross margins expanded by a strong 201 bps y-o-y to 65.4%. This can be attributed to strong product launches the company had in the recent period. As a result, the EBITDA margins expanded by 126 bps y-o-y to 21.9% and reported PAT increased at a strong pace of 23.1% y-o-y to Rs. 622.5 crore, (versus internal estimate of Rs. 570.9 crore and street estimate of Rs. 563.5 crore.).

Q3FY2023 Conference Call Highlights

- **R&D spend to rise:** The company expects R&D investments to be at 7-8% of sales in FY2023. However, it is expected to be 8-9% of sales over medium – long term. R&D on generic is expected to remain stable while it will be more on NCEs and biosimilars, which is likely to gradually scale up. Specialty products are being spent at 30% of total R&D spend towards clinical programs while the specialty R&D spend is likely to go up as a % of the R&D spend, gradually. The company has filed for an NDA for one product in the area of metabolic disorder through 505(b)(2) route.
- **EBITDA margins to be higher y-o-y in FY2023:** For EBITDA margins there is a room for improvement as the growth momentum is expected to pick up further with strong product launches. Hence EBITDA margins can sustain, as exclusive products are in place, so ~ 21% margin levels are likely by FY2023, and it will be higher than in FY2022.
- **Revenue growth to be driven largely by the US and India:**
  - **India:** The strategic initiatives taken up over the last 2 years in terms of brand building, marketing efforts, expanding distribution, and driving innovative pipeline have driven double digit growth, in the segment, now. The company envisions to continue to outperform Industry growth in its key therapies. *Lipaglyn*, the first such NCE from India, is improving its IPM rank. Its IPM rank has gone up by 35 positions y-o-y to the 59th rank as of Q3FY2023. Biosimilars are witnessing strong volumes growth as well in India. Biologics and Biosimilars were always meant for India and emerging markets. In India these are growing at a strong pace on revenue and profits fronts. It is expected to be launched in developing countries as well, the sales from it once increases will see more growth from these biosimilars. The company expects to launch 2-3 new biosimilars over the next 2-3 years, from 14 currently.
  - **Consumer Business:** The company has seen inflation hurting margins over the last few quarters. Nevertheless, the trend is cooling down for its key inputs, except for the milk prices. The company has taken price hikes and is likely to show impact of the same from next quarter. The company continues to gain market share in Glucon – D, Nycil, and Ever Yuth brands.
  - **US business:** Sales growth in Q3FY2023 was driven by growth in base business and seasonality in Q3FY2023. The company has witnessed consistent QoQ growth in all the quarters so far of FY2023 from the US. The company has launched 6 new products in the US market and received approvals for 14 new products including 3 tentative approvals. The approved products include Estradiol Transdermal System (twice weekly). It is the first such product approval from Moraiya facility. In January 2023, the company launched Topiramate ER capsules (gTrokendi) as the first generic player. The company has filed 9 ANDAs in Q3FY2023 while it has 99 ANDAs pending approval from the USFDA as of Q3FY2023.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Total Operating revenues	4,362.3	3,639.9	19.8	4,134.8	5.5
Expenditure	3,406.3	2,888.2	17.9	3,319.4	2.6
EBITDA	956.0	751.7	27.2	815.4	17.2
Depreciation	181.6	177.0	2.6	181.8	-0.1
EBIT	774.4	574.7	34.7	633.6	22.2
Interest	32.8	31.1	5.5	35.1	-6.6
Other Income	38.5	60.7	-36.6	44.4	-13.3
PBT	780.1	604.3	29.1	642.9	21.3
Taxes	195.2	110.7	76.3	137.0	42.5
Adjusted PAT	584.9	493.6	18.5	505.9	15.6
Minority Interest	-37.6	-12.1	NM	-11.2	NM
Reported PAT	622.5	505.7	23.1	517.1	20.4
Margins			**BPS**		**BPS**
EBITDA %	21.9	20.7	126.3	19.7	219.5
NPM %	13.4	13.6	-15.3	12.2	117.3
Tax rate %	25.0	18.3	670	21.3	371.3

Source: Company; Sharekhan Research

Revenue break-up Rs cr

Revenue break up (Rs crore)	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
India	**1,664**	**1,461**	**13.9%**	**1,688**	**-1.4%**
Human formulations	*1,248*	*1,079*	*15.7%*	*1,265*	*-1.3%*
Consumer Wellness	*416.0*	*382.0*	*8.9%*	*423*	*-1.6%*
US Formulation	1,914	1,504	27.2%	1,708	12.0%
EM & LATAM Formulations	291	291	0.1%	331	-12.0%
Europe Formulations	83	68	22.3%	54	53.8%
APIs	166	165	0.8%	112	49.0%
Alliances	42	40	3.2%	50	-17.1%
Grand Total	**4,160**	**3,529**	**17.9%**	**3,943**	**5.5%**
OOI	203	111	83.3%	192	5.4%
Total Operating revenues	**4,362**	**3,640**	**19.8%**	**4,135**	**5.5%**

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 dampeners. 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. With a 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 strengthen 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 a changed PT of Rs. 572:** Zydus Lifesciences has been witnessing strong sales growth in India and the US on the back of strong product launches. Additionally, as expected it has introduced the Estradiol Transdermal System (twice weekly) product, first one, from its Moraiya facility after it has been cleared by the USFDA, recently. It expects to launch nearly 3 such products in the near term. The company's India business 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 expect the company to register revenue and earnings CAGR of 10.1% and 12.0% (versus 8.9% and 11.5%, earlier, respectively, over FY2022-FY2025E). The stock is trading at a reasonable valuation of 16.9x/15.2x its FY2024/FY2025 EPS estimates. We continue to apply a PE of 20.0x on its revised FY2025 EPS and arrive at a price target (PT) of Rs. 572 (Rs. 563), indicating an upside of 32%. Thus, we maintain our Buy rating on the company.

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBITDA (x)			RoE (%)		
				FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
Zydus Lifescience	435.0	101.2	44,022.0	18.8	16.9	15.2	12.4	10.8	9.2	12.6	12.7	12.6
Cipla	1022.3	80.6	82,397.4	30.4	24.8	20.8	18.3	15.8	13.2	13.7	14.7	15.2
Dr Reddy's	4,358.4	16.6	72,479.4	16.8	14.5	12.4	9.7	8.4	6.6	19.9	19.7	19.6

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 favorably 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	SBI Funds Management	4.61
2	Life Insurance Corp India	3.19
3	Govt Pension Fund	2.48
4	BlackRock Inc.	2.54
5	Norges Bank	2.31
6	Vanguard Group Inc.	2.12
7	HDFC AMC	1.64
8	NPS Trust	1.55
9	UTI AMC	1.09
10	Schroders PLC	1.02

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

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.

Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. 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.