

29th August 2024

Natco Pharma – BUY

Investment Thesis

- Natco Pharma (Natco) thrives in complex generics (Para IV & FTF) and it focuses on molecules going off-patent with limited competition and high entry barriers in targeted therapies with a low-risk approach. Collaborating with global pharmaceutical players, Natco benefits from their expertise in navigating the regulatory hurdles (litigation, ANDA approvals) for US market entry. This partnership also allows for multi-site production, multi-sourcing arrangements and risk mitigation and ensuring a steady supply chain.
- In the export formulations segment they are notably amongst the top 10 generics player in Canada and focus exports on niche opportunities in US, Canada, Brazil, and emerging markets. Geographic expansion targets Southeast Asia, MENA, and LATAM (Colombia subsidiary). The product pipeline includes a niche portfolio comprising of 28 Para IVs in various therapeutic segments such as Oncology, Diabetology & Cardiology. Natco has also won large tenders in Saudi Arabia, Thailand, Hong Kong and Ukraine expanding its geographical presence. These high margin treatment molecules and expansion in other markets offers greater revenue visibility in the coming years.
- Natco has been one of the pioneers in the branded oncology medicines and is one of the top three companies operating in this segment in India and it is widening its existing product range by introducing additional therapy options for liver, kidney and prostate cancer. Natco has also strengthened its portfolio in cardiology with anticoagulants, anti-hypertensives, metabolic disorder therapies with novel products and fortified anti-diabetic portfolio by introducing new-age gliptins like Sitagliptin, Linagliptin and Vildagliptin. This ensures deeper market penetration in existing and new therapeutic segments.
- Their API segment mirrors this focus with complex oncology molecules and Natco is making significant developments in venturing into new therapeutic segments CNS and Orphan indications. In-house key starting material development also provides a competitive advantage. Natco currently hold a portfolio of 45 US DMFs in niche therapeutic segment with exports spanning across US, Europe and Latin America.
- Natco's CHS division leverages its expertise for affordable, innovative crop solutions. They register niche molecules (Chlorantraniliprole, etc.) domestically and internationally. A strong chemistry team prioritizes developing cost-effective Active Ingredients and targets niche products post-IP assessment. This focus on innovation extends to high-quality formulations with export market potential.
- Natco Pharma strategically invested ~\$5 million in Cellogen Therapeutics (\$2 million) to expand its offerings in cell therapy and bone marrow transplant and EywaPharma (\$3 million) to strengthen its formulation offerings during Jan-Feb 2024. They further bolstered their US presence by acquiring Dash Pharmaceuticals (now Natco Pharma USA LLC), enabling direct market access for product launches (Ondansetron, Nitroglycerin, Armodafinil) and in-licensing opportunities.

Financials

- Natco's Q1FY'25 revenue stood at Rs. 1,411 Cr growing by 21.6% YoY and 27.6% QoQ. This was driven by a growing export formulations segments which focuses on niche, Para IV and First-to-File high margin molecules and their deeper penetration in existing and new geographies.

Consol. (Rs.Cr)	FY22	FY23	FY24	FY25E	FY26E
Revenue	1,945	2,707	3,999	5,078	6,094
EBITDA	264	936	1,751	2,031	2,377
EBITDA Margin %	13.5%	34.6%	43.8%	40.0%	38.0%
PAT	170	715	1,388	1,605	1,905
EPS	9.3	39.2	77.5	89.5	106.2
PE	161.7x	38.4x	19.4x	16.8x	14.2x
RoE	4.1%	15.7%	25.9%	24.1%	22.7%

CMP : Rs.1,506

Target Price : Rs.1,865

Upside : 23%+

Stop Loss : Rs.1,270 (Closing basis)

Stock Data

Market Cap (Rs. Crs)	27,011
Market Cap (\$ Mn)	3,130
Shares O/S (in Mn)	179
Avg. Volume (1 month)	1,334,352
52-Week Range (Rs.)	1,540 / 724

Shareholding Pattern

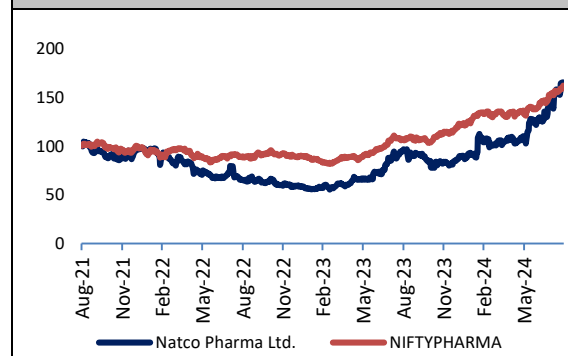
Promoters	49.71%
FIIIs	17.45%
Institutions	7.86%
Others (incl. body corporate)	24.99%

Key Ratios

Div Yield	0.62%
TTM PE	16.60x
ROE	25.94%
TTM EPS (Rs.)	91.41/-

Stock Performance

Performance (%)	1M	6M	1Yr
ABSOLUTE	14.3%	56.5%	72.0%
NIFTY PHARMA	6.1%	21.4%	52.0%



- Consolidated operating EBITDA for Q1 FY25 increased by 52.5% YoY and 61.9% QoQ reaching Rs. 805Cr and EBITDA margins expanded 1,300 bps YoY to 59.1%. This robust expansion and growth in margins was driven by expanding high margin, niche product portfolio with high entry barriers and its strong R&D capabilities in complex Para IV and FTF molecules within house manufacturing of several KSMs (Key Starting Materials)
- Consolidated PAT for Q1 FY25 stood at Rs. 668 Cr growing by 59.0% YoY and 73.1% QoQ. This growth was driven by broadening the spectrum of its oncology business and deeper penetration of high margin molecules in new and existing geographies like Canada and Europe.

Key Business Highlights

- Natco Pharma Limited is a vertically integrated, R&D-focused pharmaceutical company that develops, manufactures, and markets finished dosage formulations (FDF) and active pharmaceutical ingredients (APIs). The company specializes in niche therapeutic areas and complex products, with a global presence spanning over 50 countries. Natco's primary markets for FDF products include the United States, India, Europe, and other regions, with operations in key geographies through its subsidiaries. The company's business model emphasizes innovation, vertical integration, and strategic market expansion to maintain its competitive edge in the pharmaceutical industry.
- In the formulations and APIs segment, Natco has established a strong presence in both domestic and international markets. The company is among the top 10 generics players in Canada and focuses on niche opportunities in the US, Brazil, and emerging markets. Natco's product pipeline includes 28 Para IV filings across various therapeutic segments such as Oncology, Diabetology, and Cardiology. In India, Natco is a pioneer in branded oncology medicines, ranking among the top 3 companies in this segment. The company has expanded its portfolio to include cardiology products (anticoagulants, anti-hypertensives), metabolic disorder therapies, and anti-diabetic medications. In the API sector, Natco primarily produces for captive consumption and export to markets such as Brazil, Europe, and the USA. The company's API capabilities include multi-step synthesis, semi-synthetic fusion technologies, high-potency APIs, and peptides, with a portfolio of 45 US Drug Master Files (DMFs) in niche therapeutic segments.
- Natco Pharma has diversified into two additional business segments: Crop Health Sciences (CHS) and Contract Manufacturing. The CHS division leverages the company's expertise in organic chemistry to develop affordable, innovative crop solutions. This division focuses on registering niche molecules both domestically and internationally, with a strong chemistry team prioritizing the development of cost-effective Active Ingredients and targeting niche products post-IP assessment. The Contract Manufacturing business involves selected partnerships with pharmaceutical companies for the manufacture and supply of pharmaceutical products, further diversifying Natco's revenue streams and utilizing its manufacturing capabilities.

Valuation

Currently, Natco Pharma is trading at **Rs. 1,506**, implying a TTM PE / EBITDA multiple of 17x / 12x vs. the industrial PE/EBITDA of 35x / 17x. This suggests that Natco is undervalued compared to its peers and is a compelling investment opportunity. Given the management plans to solidify its presence in existing and new geographies and expand its product portfolio of niche, high margin molecules in existing and new specialties and its CHS division and CDMO vertical growing rapidly which support a long-term growth trajectory for top-line and bottom-line expansion. A robust pipeline of products in all its segments and its strong manufacturing and R&D capabilities position them for continued growth. As per that, we assign a **BUY** rating for **Natco Pharma** with a **target price** of **Rs. 1,865** at a PE of **17.6**, translating to an **upside** of **23%+**.

Risk & Concern

- Competition in US key products:** Natco's competition advantage due to high entry barrier may soon decline due to enhancement of manufacturing capabilities by its competitors leading to price erosion.
- Declining overall market share:** Even though Natco poses a robust pipeline in formulations, APIs and crop care fertilizers, pharmaceutical companies are exploring organic and inorganic opportunities to strengthen manufacturing capabilities and this will affect Natco's pricing and overall market share, which will lead to decrease in profitability and growth.
- Regulatory Risk:** The healthcare & pharmaceutical industry is subject to evolving regulations that could affect pricing by the inclusion of APIs and devices in the National List of Essential Medication (NLEM) and medical policy amendments, which possess a risk in operations.

Graphs & Charts

Figure 1: Net Sales & Sales Growth Trend

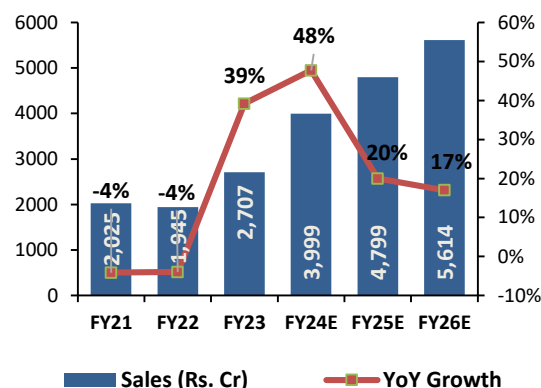


Figure 2: EBITDA & EBITDA Margin Trend

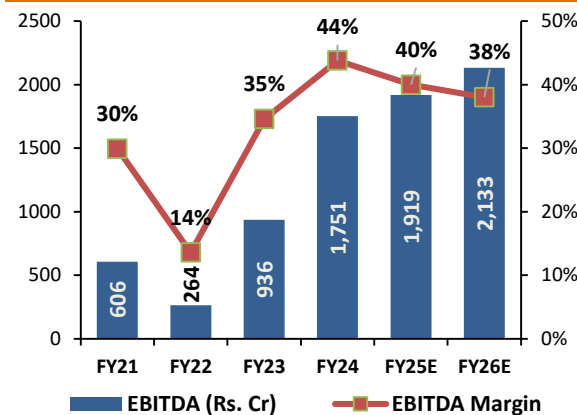


Figure 3: PAT & PAT Margin Trend

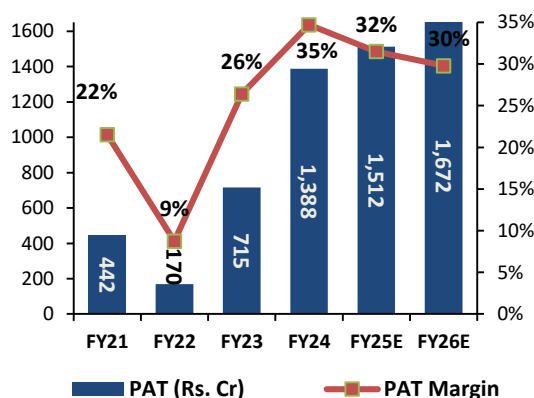
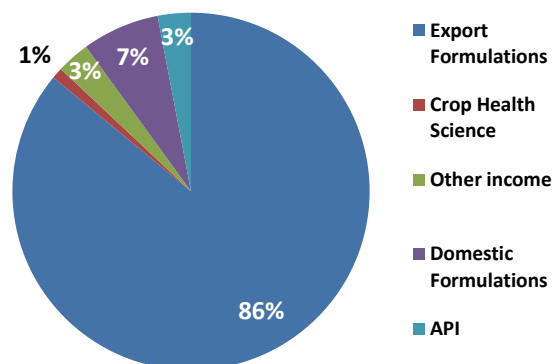


Figure 4: Segment-wise Revenue (Q1FY25)



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