

# IPCA Laboratories

BSE SENSEX 17,194	S&P CNX 5,199	<b>CMP: INR299</b>	<b>TP: INR443</b>	<b>Buy</b>								
Bloomberg Equity Shares (m)	IPCA IN 125.7	<b>YEAR End</b>	<b>Net Sales (INR M)</b>	<b>PAT (INR M)</b>	<b>EPS (INR)</b>	<b>EPS GR. (%)</b>	<b>P/E (X)</b>	<b>P/BV (X)</b>	<b>ROE (%)</b>	<b>ROCE (%)</b>	<b>EV/ Sales</b>	<b>EV/ EBITDA</b>
52-Week Range (INR)	352/225	03/10A	15,622	2,083	16.6	106.2	18.0	4.3	27.8	24.5	2.7	12.6
1,6,12 Rel Perf. (%)	-3/-3/5	03/11A	18,969	2,628	20.9	25.7	14.3	3.6	27.4	25.6	2.3	11.4
M.Cap. (INR b)	37.6	03/12E	23,076	3,308	26.3	25.8	11.4	2.9	27.9	27.4	1.9	8.2
M.Cap. (USD b)	0.8	03/13E	27,102	3,974	31.6	20.2	9.5	2.3	26.9	27.4	1.6	6.8

## IPCA's 3QFY12 performance was above estimates led by international formulations

### Key highlights

- IPCA's 3QFY12 operational performance was above estimates with revenue growth of 32% YoY to INR6.15b (est of INR5.5b), EBITDA growth of 66% at INR1.51b (est of INR1.11b) and PAT at INR639m.
- Revenue growth was led by strong 73% YoY growth in international formulation business. Branded generics business grew by 45% YoY while pure generic business (Ex-institutional business) reported growth of 33% YoY. Institutional business grew almost 3x to INR925m led by new tenders from WHO. However, domestic formulation business reported muted growth of 5.7% YoY to INR1.87b.
- EBITDA grew by 66%YoY to INR1.51b while EBITDA margins expanded by 590bps YoY to 24.6% led by 1) strong revenue growth, 2) improvement in gross margins and 3) favorable currency movement.
- Adjusted PAT remained flat at INR639m, despite robust operating performance, due to INR400m of forex losses related to foreign currency loans and hedges.

### Outlook and View

**Expect 23% earning CAGR over FY11-13:** We expect IPCA to clock FY11-13 PAT and EPS CAGR of 23% on the back of 20% revenue CAGR coupled with margin expansion. EBITDA is expected to record 29% CAGR for FY11-13. EPS growth is lower than EBITDA growth due to lower other income and increased taxes. Further, despite INR5b capex over FY12-13 (to sustain growth), the company is likely to record healthy return ratios and low gearing. The stock is currently valued at 11.4x FY12E EPS and 9.5x FY13E EPS. The stock trades at 25-50% discount to its historic and peer valuation. Reiterate **Buy** with target price of INR443 (14x FY13E EPS).

### Quarterly Performance

Y/E March	FY11				FY12				(INR Million)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE	FY11	FY12E
<b>Net Revenues (Core)</b>	<b>4,180</b>	<b>5,183</b>	<b>4,664</b>	<b>4,943</b>	<b>5,299</b>	<b>6,235</b>	<b>6,148</b>	<b>5,394</b>	<b>18,969</b>	<b>23,076</b>
YoY Change (%)	16.4	20.5	17.9	31.0	26.8	20.3	31.8	9.1	21.4	21.6
<b>EBITDA</b>	<b>712</b>	<b>1,180</b>	<b>910</b>	<b>959</b>	<b>952</b>	<b>1,580</b>	<b>1,513</b>	<b>1,196</b>	<b>3,761</b>	<b>5,241</b>
Margins (%)	17.0	22.8	19.5	19.4	18.0	25.3	24.6	22.2	19.8	22.7
Depreciation	129	137	142	150	154	176	181	206	558	717
Interest	68	43	56	147	83	118	108	112	314	421
Other Income	-4	277	116	130	118	-245	-359	794	518	307
<b>PBT before EO Expense</b>	<b>511</b>	<b>1,277</b>	<b>828</b>	<b>791</b>	<b>832</b>	<b>1,042</b>	<b>864</b>	<b>1,672</b>	<b>3,407</b>	<b>4,410</b>
Extra-Ord Expense	0	0	0	0	0	0	0	0	0	0
<b>PBT after EO Expense</b>	<b>511</b>	<b>1,277</b>	<b>828</b>	<b>791</b>	<b>832</b>	<b>1,042</b>	<b>864</b>	<b>1,672</b>	<b>3,407</b>	<b>4,410</b>
Tax	123	337	188	136	215	262	225	401	784	1,103
Rate (%)	24.1	26.4	22.7	17.2	25.9	25.2	26.0	23.9	23.0	25.0
<b>Reported PAT</b>	<b>388</b>	<b>940</b>	<b>640</b>	<b>655</b>	<b>617</b>	<b>780</b>	<b>639</b>	<b>1,272</b>	<b>2,623</b>	<b>3,308</b>
<b>Adj PAT</b>	<b>388</b>	<b>940</b>	<b>640</b>	<b>655</b>	<b>617</b>	<b>780</b>	<b>639</b>	<b>1,272</b>	<b>2,623</b>	<b>3,308</b>
YoY Change (%)	-10.9	45.9	6.8	70.0	58.8	-17.1	0.0	94.2	27.0	26.1
Margins (%)	9.3	18.1	13.7	13.3	11.6	12.5	10.4	23.6	13.8	14.3

E: MOSL Estimates

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## Topline growth driven by US, branded formulations portfolio and institutional supplies

IPCA's 3QFY12 operational performance was above estimates with revenue growth of 32% YoY to INR6.15b (est of INR5.5b), EBITDA growth of 66% at INR1.51b (est of INR1.11b) and PAT at INR639m.

Revenue growth was led by strong 73% YoY growth in international formulation business to INR2.9b partially led by favourable currency. Branded generics business grew by 45% YoY to INR614m on the back of robust growth across regions like Russia/ CIS, Asia and Africa. Pure generic business (Ex-institutional business) reported growth of 33% YoY to INR1.36b led by primarily by strong 45% YoY growth in the revenues from US. Institutional business grew almost 3x to INR925m led by new tenders from WHO.

However, domestic formulation business reported muted growth of 5.7% YoY to INR1.87b due to continued slow-down in anti-malaria business, increased competition in anti-infective segment and slower growth in CVS segment due to divisional restructuring.

### Revenue mix (INR m)

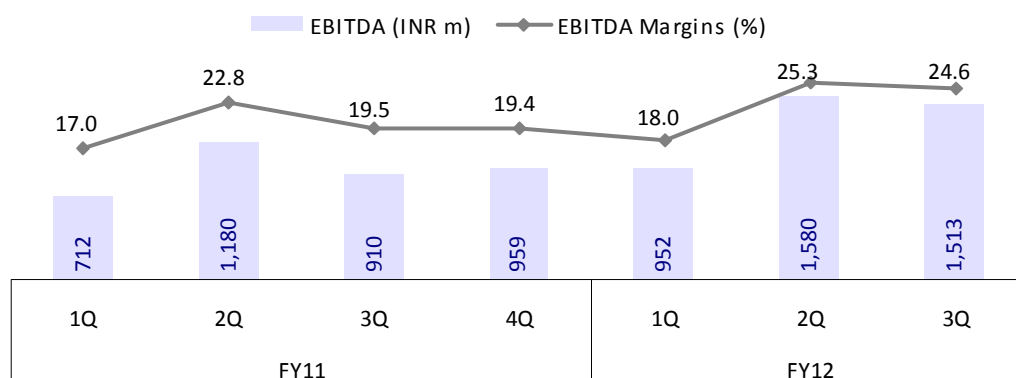
	3QFY12	3QFY11	YoY Chng (%)	2QFY12	QoQ Chng (%)
Domestic formulations	1,876	1,775	5.7	2,292	-18.2
Export formulations	2,898	1,671	73.4	2,605	11.3
<b>Total formulations</b>	<b>4,774</b>	<b>3,446</b>	<b>38.5</b>	<b>4,897</b>	<b>-2.5</b>
Domestic APIs	333	322	3.3	356	-6.7
Export APIs	911	865	5.3	927	-1.7
Total APIs	1,244	1,187	4.8	1,283	-3.1
Total	6,018	4,634	29.9	6,180	-2.6

Source: Company/MOSL

### EBITDA at INR1.5b was above our estimate

EBITDA grew by 66%YoY to INR1.51b while EBITDA margins expanded by 590bps YoY to 24.6% led by 1) strong revenue growth, 2) improvement in gross margins on the back of favorable sales mix and 3) favorable currency movement.

### EBITDA & Margin Trend



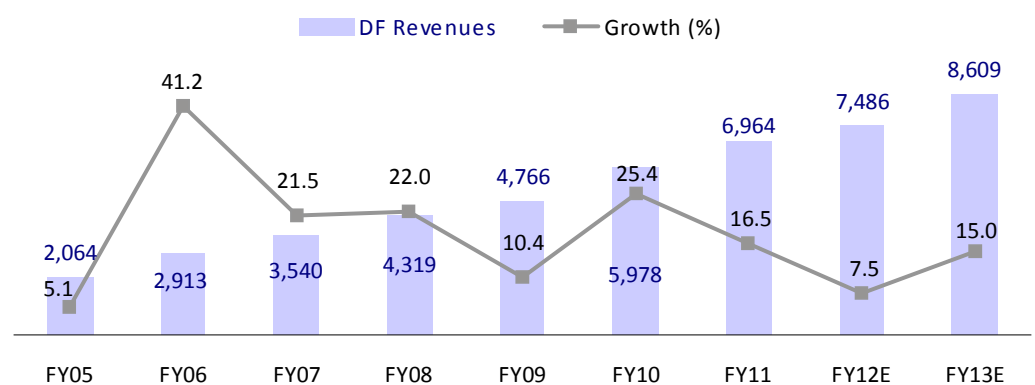
Source: Company/MOSL

Adjusted PAT remained flat at INR639m, despite robust operating performance, due to INR400m of forex losses related to foreign currency loans and hedges vs forex gain of INR112m in 3QFY11.

### India formulations business to recover in coming quarters

IPCA's India formulations (DF) business has recorded muted growth of only 7% for 9MFY12 due to: 1) Lower incidence of malaria in the country (IPCA is a leading player in the anti-malarial market), 2) Divisional restructuring of the business with the company forming 12 different focused divisions to ensure focused product promotion and doctor coverage and 3) Significant attrition in the sales force which now has been arrested. Management has guided for a recovery of growth in this business with 4QFY12 growth expected at 14% and FY13 growth estimated at 15-16%. We note that the company has recorded 22.5% CAGR in this business for the FY05-11 period and we view the lower growth in FY12 as a temporary blip. We estimate growth for this business to recover to 15% for FY13 (in-line with mgmt guidance).

#### Domestic formulation revenues trend (INR m)



Source: Company/MOSL

### Indore SEZ - US FDA approval could be a positive trigger

IPCA has set up its Indore SEZ at a cost of INR2b and has been awaiting US FDA inspection/approval for the past 2 years. This SEZ is an important determinant of IPCA's revenue growth in the US market as this SEZ is likely to address to key issues for IPCA, viz., new product approvals and availability of increased capacities (IPCA's US business is currently facing capacity constraints). The US FDA has recently inspected this SEZ. While the final US FDA approval is still awaited, IPCA management does not expect any major hurdles in getting the approval. A successful US FDA approval for this facility will be a positive trigger for the company as it will be able to launch new products in the US as well as undertake a site transfer for already commercialized products to the new facility to take advantage of the expanded capacity, thus driving strong growth for the company's US business. We estimate this SEZ to contribute ~USD20m to IPCA's topline for FY13. Management has indicated that at peak capacity utilization (likely in the next 3 years), the SEZ can generate peak sales of INR4b.

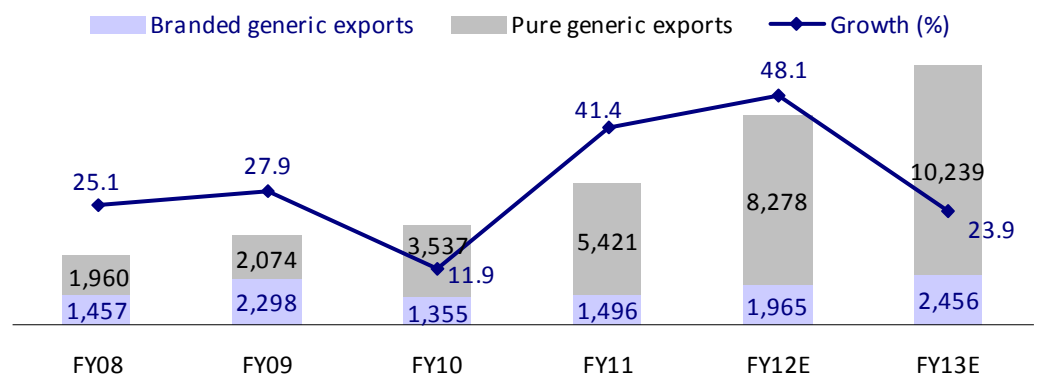
**Institutional supplies: Anti-malarial formulation presents significant revenue ramp-up potential**

IPCA has obtained WHO pre-qualification for supply of Artemether-Lumefantrine (an anti-malaria formulation) to the African continent. This is a USD400m market with only 3 other players. This is a lucrative product opportunity with significantly high EBITDA margins at ~32%. We note that IPCA is the only fully integrated player hence enjoys significant advantage over other players in terms of ramping up the business. Currently Novartis has the largest share in the institutional tender business for the product. IPCA's revenue from this product has increased from INR300m in FY10 to INR1.2b in FY11. For the 9MFY12, revenues for this segment has ramped-up to INR2.36b and the management has guided for ending the year at INR3b in revenues and about 20% growth for this business in FY13. Our revenue estimates at INR3.1b for FY12 and INR3.6b for FY13 factor-in this expected ramp-up.

**International formulations business to record 35% CAGR for FY11-13**

We expect a significant ramp-up in IPCA's international formulations revenues led by 72% CAGR for the institutional supplies, 28% CAGR for branded formulations and 26% CAGR for generic supplies to regulated markets. Pure generic supplies (incl institutional & regulated market formulations) is expected to record 37% CAGR for FY11-13 led by 72% growth for institutional supplies and 53% CAGR in supplies to US. Institutional supplies are expected to ramp-up significantly mainly as the company has commenced supply under the new tenders which it had won some time back. US growth will be led by two main factors: 1) New approvals and launches and 2) Availability of expanded capacities post the US FDA approval for the SEZ. Branded generic supplies to emerging markets should record 28% CAGR led by strong growth in all three main geographies, viz., CIS, Asia & Africa. European generic revenues are expected to record a more modest 12% CAGR for FY11-13. Overall the international formulation revenues are expected to record 26% CAGR for FY11-13.

**IPCA - Significant ramp-up in International Formulations (INR m)**



Source: Company/MOSL

### Upgrading earnings by 14-22%

- Given the strong performance in last two quarters along with increase in guidance we are revising our estimates upwards.
- We are increasing revenue estimates for FY12 and FY13 by 3% and 2% respectively to take into account 1) Significant upgrade in institutional business, 2) downgrade in domestic formulation business and better growth in branded business.
- We are revising our EPS estimates for FY12 and FY13 by 12% to INR20.9/share and 14% to INR31.6/share respectively to take into account 1) strong growth in revenue, 2) robust Improvement in EBITDA margins led by better product mix and favorable currency 3) Better absorption of operating expense at Indore SEZ and 4) reversal of forex losses in FY13.

#### Revised Forecast (INR m)

	FY12E			FY13E		
	Revised	Old	Chg (%)	Revised	Old	Chg (%)
Net Sales	23,076	22,363	3.2	27,102	26,580	2.0
Net Profit	3,308	2,700	22.5	3,974	3,478	14.3
EPS (INR/sh)	26.3	21.5	22.4	31.6	27.7	14.1

Source: Company/MOSL

### Valuation & view

Expect 23% earning CAGR over FY11-13: We expect IPCA to clock FY11-13 PAT and EPS CAGR of 23% on the back of 20% revenue CAGR coupled with margin expansion. EBITDA is expected to record 29% CAGR for FY11-13. EPS growth is lower than EBITDA growth due to lower other income and increased taxes. Further, despite INR5b capex over FY12-13 (to sustain growth), the company is likely to record healthy return ratios and low gearing. The stock is currently valued at 11.4x FY12E EPS and 9.5x FY13E EPS. The stock trades at 25-50% discount to its historic and peer valuation. Reiterate **Buy** with target price of INR443 (14x FY13E EPS).

## IPCA Laboratories: an investment profile

### Company Description

Established in 1949, IPCA Labs is one of India's better managed mid-sized pharma companies. IPCA has presence in (1) domestic branded formulations, (2) global branded and generic formulations, and (3) global APIs (active pharmaceutical ingredients). IPCA's core business strategy is to leverage its strength in manufacturing API to develop vertically integrated and highly competitive formulations. Most of the company's formulations are backed by its own APIs.

### Key investment arguments

- Strong capability in API manufacturing is at the core of IPCA's business success. The company has attained global leadership position in select APIs where it is the lowest cost producer which gives the company vertical integration advantage.
- IPCA has outperformed the industry growth over the past 5 years on the back of its rising presence in fast-growing chronic therapy segments, which contribute ~65% of domestic formulation revenue.
- We expect a significant ramp-up in IPCA's international formulations revenues led by 72% CAGR for the institutional supplies, 28% CAGR for branded formulations and 26% CAGR for generic supplies to regulated markets

### Comparative valuations

		IPCA	Glenmark	Cadila
P/E (x)	FY12E	11.4	29.5	25.4
	FY13E	9.5	14.4	14.8
P/BV (x)	FY12E	2.9	3.6	5.0
	FY13E	2.3	2.9	3.9
EV/Sales (x)	FY12E	1.9	2.6	2.8
	FY13E	1.6	2.2	2.3
EV/EBITDA (x)	FY12E	8.2	10.5	13.2
	FY13E	6.8	10.9	10.6

### Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	46.1	46.1	46.1
Domestic Inst	22.8	22.2	22.8
Foreign	9.0	10.1	9.8
Others	22.2	21.6	21.4

### Key investment risks

- As 55% of IPCA's revenue comes from exports, sustained appreciation of the Indian rupee vis-à-vis global currencies would adversely impact revenue and profits.

### Recent developments

- USFDA has visited the company's new Indore SEZ and the company expects USFDA approval for the facility in next 2 months

### Valuation and view

- **Expect 23% earning CAGR over FY11-13:** We expect IPCA to clock FY11-13 PAT and EPS CAGR of 23% on the back of 20% revenue CAGR coupled with margin expansion.
- The stock is currently valued at 11.4x FY12E EPS and 9.5x FY13E EPS. Reiterate **Buy** with target price of INR443 (14x FY13E EPS)

### Sector view

- Regulated markets would remain the key sales and profit drivers in the medium term. Japan is expected to emerge as the next growth driver, particularly for companies with a direct marketing presence.
- We are overweight on companies that are towards the end of the investment phase, with benefits expected to start coming in from the next fiscal.

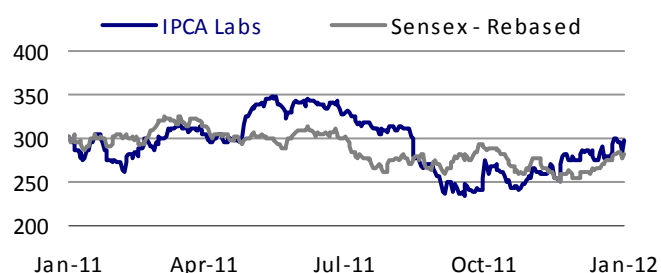
### EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	26.3	22.9	14.9
FY13	31.6	27.4	15.3

### Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
299	443	48	Buy

### Stock performance (1 year)



## Financials and Valuation

Income Statement		(INR Million)				
Y/E March	2009	2010	2011	2012E	2013E	
<b>Net Revenues</b>	<b>12,888</b>	<b>15,622</b>	<b>18,969</b>	<b>23,076</b>	<b>27,102</b>	
Change (%)	21.0	21.2	21.4	21.6	17.4	
<b>EBITDA</b>	<b>2,653</b>	<b>3,335</b>	<b>3,761</b>	<b>5,241</b>	<b>6,239</b>	
Margin (%)	20.6	21.3	19.8	22.7	23.0	
Depreciation	397	467	558	717	867	
<b>EBIT</b>	<b>2,257</b>	<b>2,868</b>	<b>3,203</b>	<b>4,524</b>	<b>5,372</b>	
Int. and Finance Charge:	318	264	314	421	473	
Other Income - Rec.	-756	88	518	307	400	
<b>PBT before EO Expense</b>	<b>1,183</b>	<b>2,692</b>	<b>3,407</b>	<b>4,410</b>	<b>5,299</b>	
Extra Ordinary Expense/i	0	29		0	0	
<b>PBT after EO Expense</b>	<b>1,183</b>	<b>2,663</b>	<b>3,407</b>	<b>4,410</b>	<b>5,299</b>	
Current Tax	155	485	770	882	1,060	
Deferred Tax	78	142	14	221	265	
Tax	233	627	784	1,103	1,325	
Tax Rate (%)	19.7	23.3	23.0	25.0	25.0	
<b>Reported PAT</b>	<b>951</b>	<b>2,035</b>	<b>2,623</b>	<b>3,308</b>	<b>3,974</b>	
Less: Minority Interest	-57	-18	-5	0	0	
<b>Net Profit</b>	<b>1,008</b>	<b>2,054</b>	<b>2,628</b>	<b>3,308</b>	<b>3,974</b>	
<b>Adj PAT</b>	<b>1,008</b>	<b>2,083</b>	<b>2,628</b>	<b>3,308</b>	<b>3,974</b>	

Balance Sheet		(INR Million)				
Y/E March	2009	2010	2011	2012E	2013E	
Equity Share Capital	250	250	251	251	251	
Total Reserves	6,063	8,399	10,265	12,911	16,090	
<b>Net Worth</b>	<b>6,313</b>	<b>8,649</b>	<b>10,516</b>	<b>13,162</b>	<b>16,342</b>	
Deferred liabilities	651	793	807	1,028	1,293	
Total Loans	4,594	4,545	5,308	6,308	6,308	
<b>Capital Employed</b>	<b>11,554</b>	<b>13,981</b>	<b>16,625</b>	<b>20,498</b>	<b>23,942</b>	
Gross Block	7,790	8,812	9,884	12,184	14,484	
Less: Accum. Deprn.	2,022	2,433	2,892	3,609	4,476	
<b>Net Fixed Assets</b>	<b>5,768</b>	<b>6,379</b>	<b>6,992</b>	<b>8,575</b>	<b>10,008</b>	
Capital WIP	144	383	1,132	1,132	1,132	
Investments	412	325	408	634	634	
<b>Curr. Assets</b>	<b>7,392</b>	<b>8,992</b>	<b>10,586</b>	<b>13,694</b>	<b>16,469</b>	
Inventory	3,062	3,802	4,664	5,722	6,789	
Account Receivables	3,391	3,880	4,637	5,657	6,789	
Cash and Bank Balance	107	108	104	900	1,231	
Loans & Advances	832	1,201	1,182	1,414	1,660	
<b>Curr. Liability &amp; Prov.</b>	<b>2,162</b>	<b>2,097</b>	<b>2,493</b>	<b>3,536</b>	<b>4,300</b>	
Account Payables	1,962	1,850	2,073	2,893	3,395	
Provisions	200	247	420	643	905	
<b>Net Current Assets</b>	<b>5,230</b>	<b>6,895</b>	<b>8,093</b>	<b>10,158</b>	<b>12,169</b>	
<b>Appl. of Funds</b>	<b>11,554</b>	<b>13,981</b>	<b>16,625</b>	<b>20,498</b>	<b>23,942</b>	

E: Most Estimates

Ratios						
Y/E March	2009	2010	2011	2012E	2013E	
<b>EPS (INR)</b>	<b>8.1</b>	<b>16.6</b>	<b>20.9</b>	<b>26.3</b>	<b>31.6</b>	
Cash EPS	11.2	20.1	25.3	32.0	38.5	
BV/Share	50.5	69.1	83.7	104.7	130.0	
<b>Valuation (x)</b>						
P/E	37.1	18.0	14.3	11.4	9.5	
Cash P/E	26.6	14.8	11.8	9.3	7.8	
P/BV	5.9	4.3	3.6	2.9	2.3	
EV/Sales	3.3	2.7	2.3	1.9	1.6	
EV/EBITDA	15.9	12.6	11.4	8.2	6.8	
Dividend Yield (%)	0.9	1.1	1.2	1.8	2.1	
FCF per Share	1.1	-0.1	3.9	8.7	12.7	
<b>Return Ratios (%)</b>						
EBITDA Margins (%)	20.6	21.3	19.8	22.7	23.0	
Net Profit Margins (%)	7.8	13.3	13.9	14.3	14.7	
RoE	16.5	27.8	27.4	27.9	26.9	
RoCE	14.8	24.5	25.6	27.4	27.4	
<b>Working Capital Ratios</b>						
Asset Turnover (x)	1.7	1.8	1.9	1.9	1.9	
Fixed Asset Turnover (x)	2.6	2.6	2.8	3.0	2.9	
Debtor (Days)	93	88	87	87	89	
Inventory (Days)	87	89	90	91	91	
Working Capital Turnove	145	159	154	146	147	
<b>Growth (%)</b>						
Sales	21.0	21.2	21.4	21.6	17.4	
EBITDA	46.0	25.7	12.8	39.3	19.0	
PAT	5.2	106.6	26.2	25.8	20.2	
<b>Leverage Ratio (x)</b>						
Current Ratio	3.4	4.3	4.2	3.9	3.8	
Interest Cover Ratio	7.1	10.9	10.2	10.7	11.4	
Debt/Equity	0.7	0.5	0.5	0.5	0.4	

Cash Flow Statement		(INR Million)				
Y/E March	2009	2010	2011	2012E	2013E	
Oper. Profit/(Loss) before	2,653	3,335	3,761	5,241	6,239	
Interest/Dividends Recc	-756	88	518	307	400	
Direct Taxes Paid	-155	-485	-770	-882	-1,060	
(Inc)/Dec in WC	-736	-1,664	-1,203	-1,268	-1,680	
<b>CF from Operations</b>	<b>1,007</b>	<b>1,274</b>	<b>2,307</b>	<b>3,398</b>	<b>3,899</b>	
EO Expense / (Income)	0	29	0	0	0	
<b>CF from Operating incl EO</b>	<b>1,007</b>	<b>1,245</b>	<b>2,307</b>	<b>3,398</b>	<b>3,899</b>	
(inc)/dec in FA	-869	-1,261	-1,821	-2,300	-2,300	
(Pur)/Sale of Investment	-316	86	-83	-225	0	
<b>CF from Investments</b>	<b>-1,185</b>	<b>-1,174</b>	<b>-1,904</b>	<b>-2,525</b>	<b>-2,300</b>	
Issue of shares	-1	1	1	0	0	
(Inc)/Dec in Debt	1,060	-50	762	1,007	0	
Interest Paid	-318	-264	-314	-421	-473	
Dividend Paid	-323	-409	-468	-662	-795	
Others	-227	653	-388	0	0	
<b>CF from Fin. Activity</b>	<b>191</b>	<b>-70</b>	<b>-407</b>	<b>-76</b>	<b>-1,268</b>	
<b>Inc/Dec of Cash</b>	<b>13</b>	<b>1</b>	<b>-4</b>	<b>797</b>	<b>331</b>	
Add: Beginning Balance	94	107	108	104	900	
<b>Closing Balance</b>	<b>107</b>	<b>108</b>	<b>104</b>	<b>900</b>	<b>1,231</b>	

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