

Ipca Laboratories

 BSE Sensex
29,279

 S&P CNX
8,836

CMP: INR639
TP: INR790 (+24%)
Buy


Stock Info

Bloomberg	IPCA IN
Equity Shares (m)	126.2
52-Week Range (INR)	907/630
1, 6, 12 Rel. Per (%)	-17/-36/-53
M.Cap. (INR b)	80.6
M.Cap. (USD b)	1.3

Financial Snapshot (INR b)

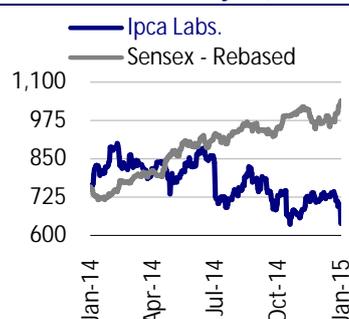
Y/E Mar	2015E	2016E	2017E
Sales	33.3	39.3	46.1
EBITDA	6.9	8.1	9.7
Net Profit	4.0	4.8	5.9
Adj. EPS (INR)	31.5	37.8	46.5
EPS Gr. (%)	-16.9	20.1	23.1
BV/Sh. (INR)	182.0	214.2	253.7
RoE (%)	18.7	19.1	19.9
RoCE (%)	21.7	22.2	23.4
P/E (x)	20.3	16.9	13.7
P/BV (x)	3.5	3.0	2.5

Shareholding pattern (%)

As on	Dec-14	Sep-14	Dec-13
Promoter	45.9	45.9	45.9
DII	11.9	11.6	12.0
FII	22.8	24.2	25.4
Others	19.4	18.3	16.7

FII Includes depository receipts

Stock Performance (1-year)



Risk-reward favorable

Key US products exempted from import alert, long term drivers intact

Event: Import alert on IPCA's Ratlam API facility

IPCA's Ratlam API facility received import alert from USFDA, following earlier Form 483 observations issued in July'14. IPCA had voluntarily halted supplies to US (including formulations) and the management earlier sounded confident of resolving the issue by 1HFY16. Owing to acute shortages in some of the key molecules of IPCA, USFDA has excluded four products from the import ban (accounting for ~85% of US business), implying partial resumption of US sales.

Exemption of key products imply earlier resumption of sales

IPCA derived INR 3b (9% of total sales) sales from US, including both API and formulation supplies. Ratlam is the sole API facility for US, and all approved ANDAs (11 in market) sourced API from this facility. Exemption of key molecules enables IPCA to resume US supplies in 4QFY15 itself, much earlier than 1HFY17 assumed in our forecasts. We believe IPCA would be able to recoup most of the existing US sales (US\$ 34m in FY14) by FY17E, with sharp price hike (6-8x) in Hydroxychloroquine (80% of US sales) expanding overall mkt size. However, new launches from pipeline (26 pending ANDAs) would be contingent upon remediation of import alert (atleast after 18-24 months).

Favorable pricing environment could imply higher revenue potential

The import alert excludes four molecules: Trimethoprim, Ondansetron, Hydroxychloroquine Sulfate and Propranolol Hydrochloride which accounted for 85% of US sales (in FY14). Among these, IPCA had a dominant 85% mkt share in Hydroxychloroquine Sulfate (Plaquenil, anti-malarial, US\$26m sales) which slipped to 12% post voluntary exit. Acute shortage in the market resulted in 6-8x price hike undertaken by other players (Cadila, Mylan), expanding mkt opportunity (to US\$120 m). Even if IPCA re-enters with 40% lower price and regains 33% market share, it would be able to garner US\$25m sales in US, enabling recovery of fixed overheads at least at key facilities for US.

Risk-reward in favor, stock correction pricing in worst case scenario

IPCA has corrected 26% since voluntary stoppage of US sales and is currently trading at 17x FY16E and 14x FY17E, at discount to its 5-yr average trading multiple as well as the sector (35%). We think this is unjustified noting robust branded formulations business (47% of sales), healthy return ratios (RoCE at 21%+), strong earnings outlook (22% EPS CAGR over FY15-17E) and low leverage (D/E at 0.2x). Our target price of INR790 values IPCA at 17x FY17E (at 25% discount to sector) noting regulatory overhang. **Key risks:** Adverse outcome of regulatory inspection by other regulators (WHO, UKMHRA, etc).

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Valuation and view

Concerns on Form 483 issued at API facility (Ratlam), subsequent stoppage of US sales and recent import alert have led to sharp stock correction in the last six months. While we believe that the regulatory overhang would weigh on valuation multiples, growth in other businesses remain healthy. IPCA's exposure to stable domestic formulation business (30% of sales) and increasing scale-up in export formulations (45% of sales) provide attractive growth prospects at compelling valuations. IPCA is currently trading at 17x FY16E and 14x FY17E EPS, a steep ~30% discount to mid-size peers. We expect the valuation gap with peers to narrow with 22% EPS growth and a robust business model.

Our target price implies 24% upside

We value IPCA on a target 1-year forward P/E multiple basis, the same methodology we use for other pharmaceutical stocks in our coverage. Our target price of INR790 values the company at P/E multiple of 17x on FY17E EPS of INR46.5. This target multiple is;

- n At 25% discount to other mid-size peers target multiple (i.e 22x), factoring overhang of regulatory issues
- n Implies a PEG of 0.8x, which is better than the sector average of 0.95x
- n At par with its historic multiple (5 yr average), given turnaround in profitability and healthy balance sheet

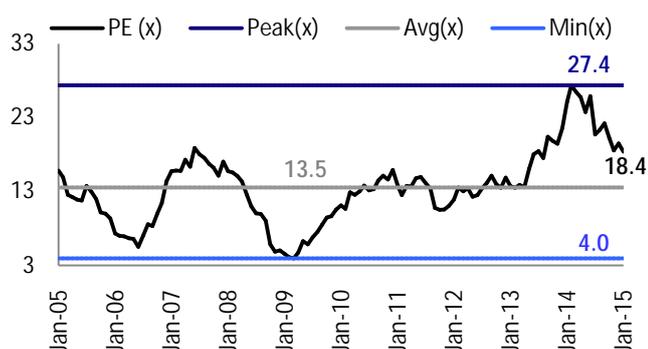
Key catalysts to drive stock's performance over the medium term are

- n Higher than expected recovery in US sales, led by sharp price hikes in key product (Hydroxychloroquine)
- n Outlook for Institutional business (anti-malarial tender), accounting for 14% of sales
- n Improvement in domestic business growth trajectory, with focus on new therapy introductions in chronic segments.

Key risks to our investment thesis

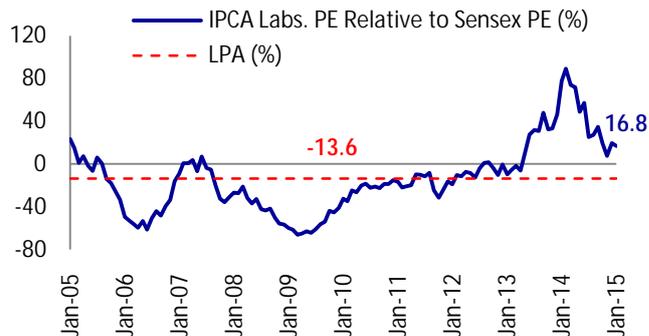
- n Adverse regulatory action by other key regulators like UK MHRA, WHO which are likely to inspect Ratlam facility over the next three months.
- n Continued weakness in emerging market currency could impair growth prospects. Branded generic formulation exports account for 10% of business.
- n Further addition of drugs in DPCO coverage could hurt domestic business.

Exhibit 1: Forward P/E band



Source: Company, MOSL

Exhibit 2: PE Relative to Sensex PE (%)



Source: Company, MOSL

Story in charts

Exhibit 3: Segment mix (%)

	FY14	FY15E	FY16E	FY17E	CAGR 15-17
India	30	35	34	35	18
Europe	12	14	14	14	20
US/CAN	8	4	5	5	42
Branded Biz	10	12	13	14	26
Inst. Biz	14	10	10	9	11
API	26	26	24	23	13
Total	100	100	100	100	18

Exhibit 4: Segment Growth (%)

	FY12	FY13	FY14	FY15E	FY16E	FY17E
India	8	17	10	18	18	18
Europe	5	0	29	18	22	18
US/CAN	54	21	18	-55	65	23
Others	28	41	20	59	6	30
Branded Biz	30	26	33	20	25	28
Inst. Biz	146	33	10	-22	12	10
API	16	22	15	4	12	13
Total	23	19	16	3	19	17

Exhibit 5: Exempted products cover 85% of US sales

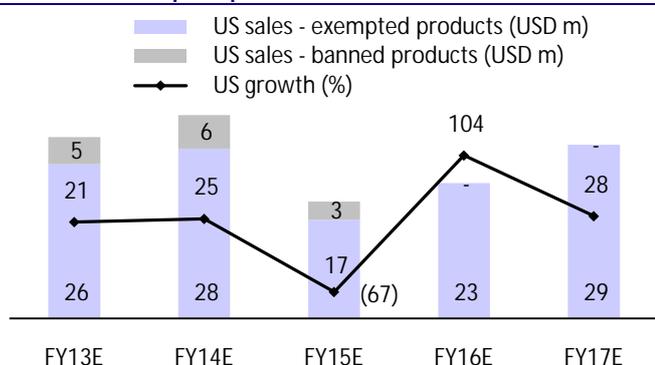


Exhibit 6: Hydrochloroquine market share trend in US

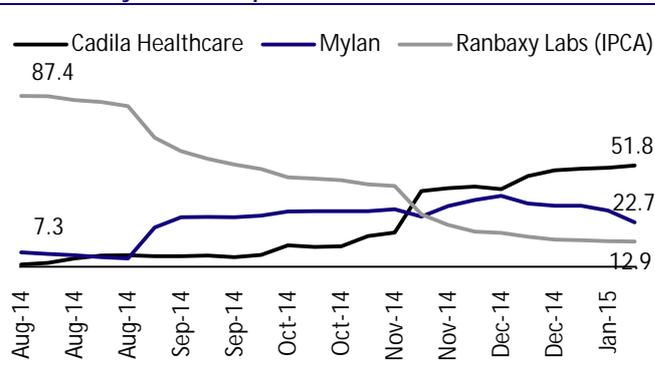


Exhibit 7: Formulation led sales growth

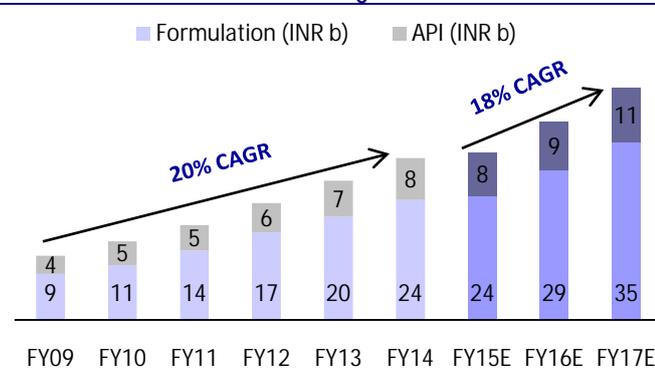


Exhibit 8: EBITDA growth to recover in FY16-17E

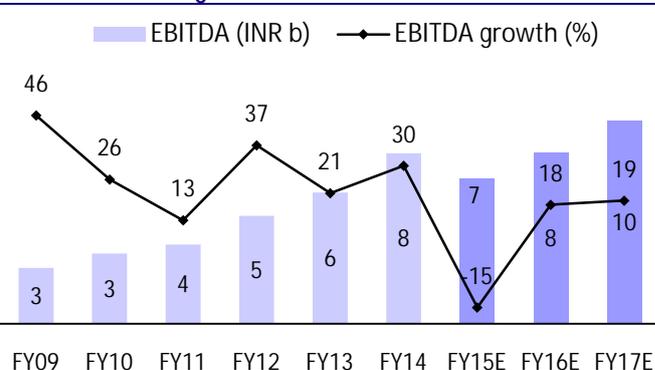
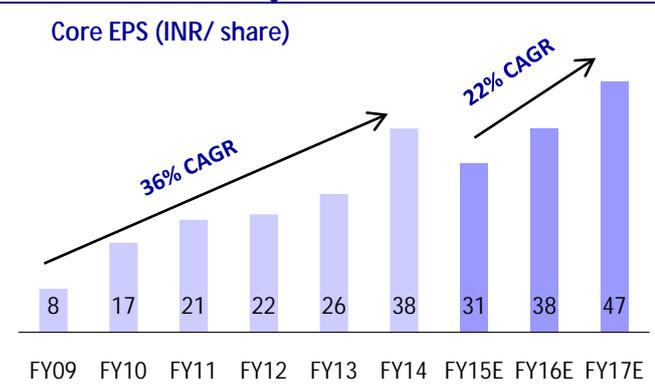
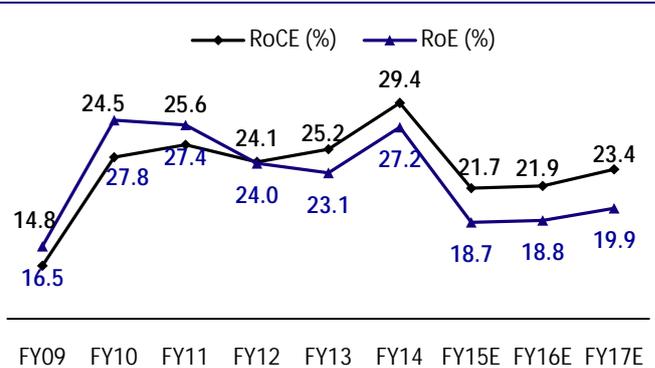


Exhibit 9: Robust earning outlook ...



Source: Company, MOSL

Exhibit 10: RoEs at 21-23%



Source: Company, MOSL

Financials and valuations

Income Statement		(INR Million)						
Y/E March	2010	2011	2012	2013	2014	2015E	2016E	2017E
Net Revenues	15,622	18,969	23,587	28,131	32,818	33,320	39,290	46,100
Change (%)	21.2	21.4	24.3	19.3	16.7	1.5	17.9	17.3
EBITDA	3,335	3,761	5,135	6,232	8,106	6,901	8,121	9,663
Margin (%)	21.3	19.8	21.8	22.2	24.7	20.7	20.7	21.0
Depreciation	467	558	671	867	1,031	1,580	1,836	2,151
EBIT	2,868	3,203	4,464	5,365	7,074	5,321	6,285	7,512
Int. and Finance Charges	264	314	413	334	269	229	269	283
Other Income - Rec.	88	518	-408	-488	-500	259	262	500
PBT before EO Expense	2,692	3,407	3,643	4,543	6,306	5,351	6,277	7,729
EO Expense/(Income)	29		0	0	0	0	0	0
PBT after EO Expense	2,663	3,407	3,643	4,543	6,306	5,351	6,277	7,729
Current Tax	485	770	754	927	1,357	1,177	1,381	1,700
Deferred Tax	142	14	127	372	167	202	126	155
Tax	627	784	881	1,299	1,524	1,379	1,507	1,855
Tax Rate (%)	23.3	23.0	24.2	28.6	24.2	25.8	24.0	24.0
Reported PAT	2,035	2,623	2,762	3,243	4,782	3,972	4,771	5,874
Less: Minority Interest	-18	-5	0	0	0	0	0	0
Net Profit	2,054	2,628	2,762	3,243	4,782	3,972	4,771	5,874
Adj PAT	2,083	2,628	2,762	3,243	4,782	3,972	4,771	5,874
Adj PAT growth (%)	106.6	26.2	5.1	17.4	47.4	-16.9	20.1	23.1

Balance Sheet		(INR Million)						
Y/E March	2010	2011	2012	2013	2014	2015E	2016E	2017E
Equity Share Capital	250	251	252	252	252	252	252	252
Total Reserves	8,399	10,265	12,288	15,285	19,344	22,720	26,775	31,768
Net Worth	8,649	10,516	12,540	15,538	19,597	22,972	27,028	32,021
Deferred liabilities	793	807	932	1304	1471	1673	1799	1953
Total Loans	4,545	5,308	5,326	5,234	4,379	4,379	4,595	4,844
Capital Employed	13,981	16,625	18,798	22,075	25,447	29,025	33,422	38,818
Gross Block	8,812	9,884	13,386	15,791	19,321	24,321	28,821	33,321
Less: Accum. Deprn.	2,433	2,892	3,945	4,748	5,785	7,365	9,201	11,351
Net Fixed Assets	6,379	6,992	9,441	11,042	13,536	16,956	19,620	21,969
Capital WIP	383	1,132	945	1,292	1,649	1,649	1,649	1,649
Investments	325	408	341	90	92	92	92	92
Curr. Assets	8,992	10,586	12,547	14,545	16,827	16,627	19,486	23,818
Inventory	3,802	4,664	6,699	7,410	8,476	8,671	10,222	11,992
Account Receivables	3,880	4,637	3,491	4,178	4,495	4,746	5,595	6,564
Cash and Bank Balance	108	104	122	582	763	289	333	1,097
Loans & Advances	1,201	1,182	2,235	2,374	3,093	2,921	3,336	4,166
Curr. Liability & Prov.	2,097	2,493	4,475	4,894	6,656	6,298	7,425	8,710
Account Payables	1,850	2,073	4,099	4,351	5,950	5,659	6,671	7,826
Provisions	247	420	377	544	706	639	753	884
Net Current Assets	6,895	8,093	8,071	9,651	10,171	10,329	12,061	15,108
Appl. of Funds	13,981	16,625	18,798	22,075	25,447	29,025	33,422	38,818

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	2010	2011	2012	2013	2014	2015E	2016E	2017E
EPS (INR)	16.6	20.9	21.9	25.7	37.9	31.5	37.8	46.5
Cash EPS	20.1	25.3	27.2	32.6	46.1	44.0	52.4	63.6
BV/Share	69.1	83.7	99.4	123.1	155.3	182.0	214.2	253.7
DPS	3.3	3.7	3.7	4.7	5.9	4.7	5.7	7.0
Payout (%)	20.1	17.9	17.0	18.1	15.4	15.0	15.0	15.0

Valuation (x)

P/E				24.9	16.9	20.3	16.9	13.7
P/BV				5.2	4.1	3.5	3.0	2.5
EV/Sales				3.0	2.6	2.5	2.2	1.8
EV/EBITDA				13.7	10.4	12.3	10.5	8.7
Dividend Yield (%)				0.7	0.9	0.7	0.9	1.1

Return Ratios (%)

RoE	27.8	27.4	24.0	23.1	27.2	18.7	19.1	19.9
RoCE	24.5	25.6	24.1	25.2	29.4	21.7	22.2	23.4

Working Capital Ratios

Fixed Asset Turnover (x)	2.6	2.8	2.9	2.7	2.7	2.2	2.1	2.2
Debtor (Days)	88	87	54	54	50	52	52	52
Inventory (Days)	89	90	104	96	94	95	95	95
Working Capital Turnover (Days)	159	154	123	118	105	110	109	111

Leverage Ratio (x)

Interest Cover Ratio	10.9	10.2	10.8	16.1	26.3	23.3	23.3	26.5
Debt/Equity	0.5	0.5	0.4	0.3	0.2	0.2	0.2	0.2

Cash Flow Statement

(INR Million)

Y/E March	2010	2011	2012	2013	2014	2015E	2016E	2017E
Oper. Profit/(Loss) before Tax	3,335	3,761	5,135	6,232	8,106	6,901	8,121	9,663
Interest/Dividends Recd.	88	518	-408	-488	-500	259	262	500
Direct Taxes Paid	-485	-770	-757	-927	-1,357	-1,177	-1,381	-1,700
(Inc)/Dec in WC	-1,664	-1,203	39	-1,119	-339	-632	-1,689	-2,283
CF from Operations	1,274	2,307	4,010	3,698	5,910	5,350	5,313	6,180
CF from Operating incl EO Expense	1,245	2,307	4,010	3,698	5,910	5,350	5,313	6,180
(inc)/dec in FA	-1,261	-1,821	-3,315	-2,752	-3,887	-5,000	-4,500	-4,500
(Pur)/Sale of Investments	86	-83	68	251	-1	0	0	0
CF from Investments	-1,174	-1,904	-3,247	-2,501	-3,888	-5,000	-4,500	-4,500
Issue of shares	1	1	1	0	0	0	0	0
(Inc)/Dec in Debt	-50	762	25	-93	-854	0	216	248
Interest Paid	-264	-314	-413	-334	-269	-229	-269	-283
Dividend Paid	-409	-468	-468	-589	-738	-596	-716	-881
Others	653	-388	111	279	20	0	0	0
CF from Fin. Activity	-70	-407	-744	-736	-1,841	-824	-769	-916
Inc/Dec of Cash	1	-4	18	461	180	-474	44	764
Add: Beginning Balance	107	108	104	122	582	763	289	333
Closing Balance	108	104	122	582	763	289	333	1,097

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