

Indoco Remedies

5 September 2017
Reuters: INDR.BO; Bloomberg: INRM IN

Foundation In Place For Ramp-up

Indoco Remedies (IRL), incorporated in 1947, is one of the pioneers in Indian pharmaceutical industry. IRL is primarily a domestic market-focused company, but over the past five years it has steadily built a strong foundation for a global presence. We initiate coverage on IRL with a Buy rating and a target price of Rs250. We see a positive risk-reward profile as the ramp-up of US business, which is contingent on resolution of a warning letter from the US Food and Drug Administration or USFDA, is currently not in the current market price. Reading the warning letter and discussions with a regulatory consultant indicates that there are chances of the company receiving an EIR by the end of 1QFY19. The issues identified in the warning letter primarily pertain to strengthening IRL's processes to ensure consistency and reliability in the quality of products that are being manufactured by it. Assuming a successful resolution of the warning letter (best case scenario), we expect the company's earnings to post 23% CAGR over FY17-FY20. In our base-case assumption, we have factored in 60% probability of resolution of the issues stated in the warning letter. In a bear-case scenario, if we assume the resolution is indefinitely delayed our target price is Rs225, which represents 16% upside from the CMP. We have arrived at our target price of Rs250 based on sum of the parts or SOTP valuation, representing 29% upside from CMP.

Investment in building an US filing portfolio is yet to deliver: Till date, IRL has invested in filing 42 ANDAs in the US of which 10 have been approved. The pending ANDAs include a few limited-competition opportunities which are potentially ophthalmic suspensions and extended release products. Among the 32 ANDAs pending final approval, 18 are ophthalmic products and 14 are oral solids. As a consequence of the warning letter issued by the USFDA, IRL has missed some time-sensitive high-value opportunities, one of which was Pataday generic (under 180-day marketing exclusivity) in partnership with Teva Pharma. However, all is not lost as the company still has some limited-competition opportunities in the pipeline.

Domestic pharmaceuticals -focus on improving productivity: IRL derives 55% of its revenues from the domestic market. Currently IRL registers more than 90% of its sales in the domestic market from acute/sub-chronic segment which grows at a slower pace than Indian pharmaceutical market or IPM. Over 2013-16, the share of acute segment in IPM declined from 68.4% to 66.8%. However, IRL continues to outperform the market where it has a presence. Despite a decline in overall share of acute segment within overall IPM, Indoco has maintained its market share within IPM. To ensure faster growth going forward, the company has made about 31 new product launches in domestic market in FY17. Sales productivity of IRL is currently the lowest in the industry and IRL is looking at addressing the same through improved product mix.

International business (ex-US) --filings in place to build on the base: The international business of IRL comprises Europe, emerging markets (Sri Lanka, Tanzania, Kenya, Myanmar), South Africa, New Zealand and Australia. As regards emerging markets, IRL is working on scaling up its business by foraying into new territories (Zambia, Cameroon and Ethiopia). In Europe, so far the company has served as a contract manufacturer where dossier ownership rests with the partner. The margins in such a case are lower. With an objective to improve margin profile in future, IRL has started filing dossiers under its own name and is also making inroads into East Europe which offers better prices for the same products. The company is also looking to focus on niche products.

STP valuation: We have valued IRL through sum of the parts methodology using average EV/EBITDA multiples based on FY19E financials. The segments within Indoco business include India, US, Europe, Emerging Markets and API/CRO. Since each of these segment has different valuation characteristics we value each of these at comparable trading multiple within that sector.

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Net sales	10,081	10,968	11,611	13,560	14,688
EBITDA	1,704	1,565	1,638	2,179	2,445
Net profit	819	771	604	991	1,044
EPS (Rs)	8.9	8.4	6.6	10.8	11.3
EPS growth (%)	(1.1)	(6.0)	(21.6)	63.9	5.4
EBITDA margin (%)	16.9	14.3	14.1	16.1	16.6
P/E (x)	21.8	23.2	29.6	18.0	17.1
P/BV (x)	3.1	2.7	2.6	2.3	2.1
EV/EBITDA (x)	11.1	12.7	12.0	8.9	7.7
RoCE (%)	21.6	14.0	14.5	21.3	22.4
RoE (%)	14.2	11.8	8.7	12.8	12.1

Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: Pharmaceutical

CMP: Rs194

Target Price: Rs250

Upside: 29%

Vishal Manchanda

Research Analyst

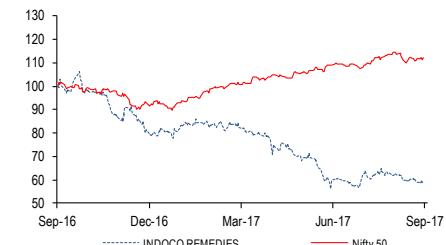
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Key Data

Current Shares O/S (mn)	92.2
Mkt Cap (Rsbn/US\$mn)	17.9/279.6
52 Wk H / L (Rs)	362/178
Daily Vol. (3M NSE Avg.)	67,052

Shareholding (%)	3QFY17	4QFY17	1QFY18
Promoter	59.2	59.1	59.1
Public	40.9	40.9	40.9
Others	-	-	-

One-Year Indexed Stock



Price Performance (%)

	1 M	6 M	1 Yr
Indoco Remedies	(2.9)	(26.7)	(39.8)
Nifty Index	(1.5)	11.4	12.5

Source: Bloomberg

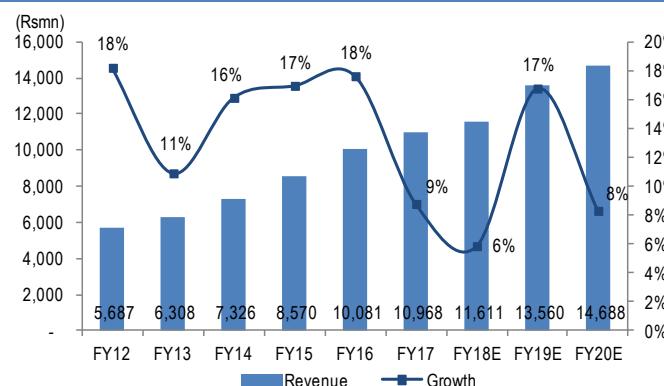
Exhibit 1: Valuation under three scenarios

Valuation (Rsmn)	Bear case	Base case	Best case
Enterprise value	22,280	24,520	29,068
Less: Net debt	1,515	1,515	1,515
Equity value	20,764	23,005	27,553
No of shares (mn)	92	92	92
Value per share (Rs)	225	250	299
CMP per share (Rs)	194	194	194
Upside (%)	16	29	54

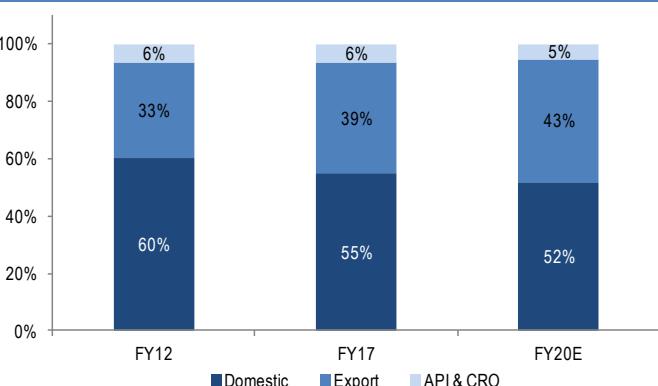
Source: Company, Nirmal Bang Institutional Equities Research

Revenues

Revenues of IRL posted a CAGR of 14% over a five-year period from FY12 to FY17. While it is primarily a domestic company (contribution of 55%), the share of export formulations steadily grew from 33% in FY12 to 39% in FY17. On the export front, the company is mainly present in the US, Europe, South Africa, Australia and New Zealand. Revenues from APIs remained stable at 6%.

Exhibit 2: Revenue and growth


Source: Company, Nirmal Bang Institutional Equities Research

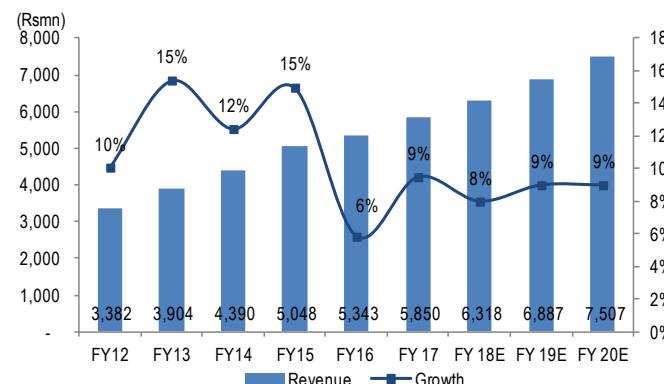
Exhibit 3: Revenue mix


Source: Company, Nirmal Bang Institutional Equities Research

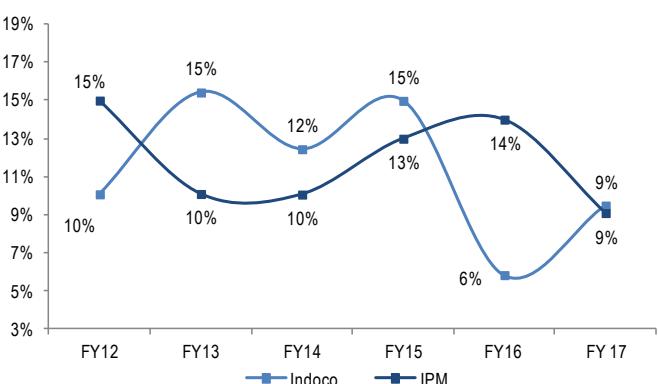
Domestic business-focus on improving productivity

IRL is ranked 31st in Indian pharmaceutical market (IPM) with a market share of around 0.7%. Domestic revenues posted a CAGR of 12% over a five-year period from FY12 to FY17.

This company's business has consistently shown double-digit growth, beating the growth of IPM, except in FY16 (when domestic restructuring was undertaken to improve the product mix). In FY17, the growth slowed down because of the short-term impact of demonetisation.

Exhibit 4: Domestic revenue and growth


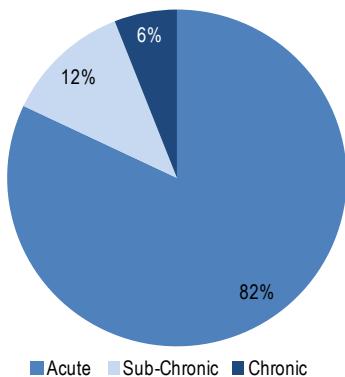
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: IRL versus IPM


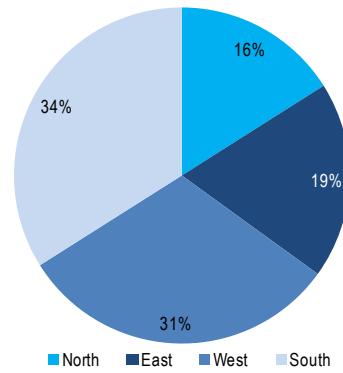
Source: Company, Nirmal Bang Institutional Equities Research

Domestic business growth has been slow because of a weak presence in the chronic segment (6%). The company had undertaken a restructuring exercise in FY16 in order to improve its product mix and shift towards chronic segment.

IRL has strong brand recall and a presence in southern and western regions of India. IRL is looking to expand to northern and eastern parts of the country. Currently, around 65% of its sales come from southern and western regions of India.

Exhibit 6: Product mix


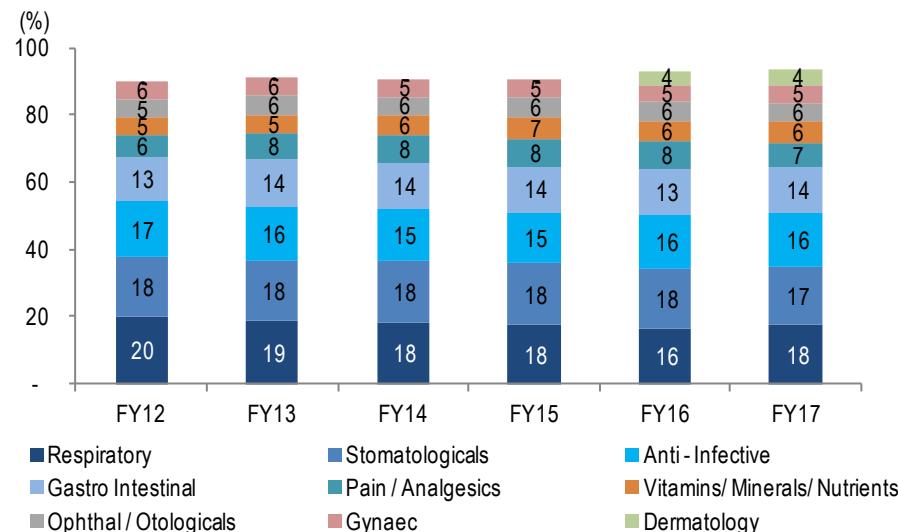
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Regional spread


Source: Company, Nirmal Bang Institutional Equities Research

Therapy segment mix

IRL caters mainly to nine therapy segments, wherein, respiratory, stomatological, anti-infective and gastro-intestinal are top four segments which contribute 64% to domestic revenues. The contribution of these therapies remained fairly stable from FY13 to FY17. Going forward, the company plans to focus on cardiac and diabetic segments, which is in line with its strategy of increasing the contribution of chronic therapies to the product mix. IRL is looking to launch niche products in these segments and avoid getting into age-old APIs where the incumbents have strong brand recall.

Exhibit 8: Therapy segment mix (%)


Source: Company, Nirmal Bang Institutional Equities Research

Brands

IRL has been the leader in the oral care space with key products such as Sensodent K and Senoform. In addition to this, some of its known brands are Cyclopam, Febrex Plus, Cital and Homide. The top 10 brands contribute around 46% to total domestic business revenues. The company has ramped up efforts to maintain and improvise its position.

Exhibit 9: Contribution from top brands

Sr. No.	Product	Segment	Brand revenues (Rsmn)			YoY growth (%)		
			FY15	FY16	FY17	FY15	FY16	FY17
1	Cyclopam	Gastrointestinal	504	541	589	15.9	7.2	8.8
2	Febrex Plus	Respiratory	496	485	603	2.7	(2.2)	24.3
3	Sensodent K	Stomatological	315	310	319	33.0	(1.6)	2.9
4	Cital	Urology	183	220	252	19.9	20.2	14.7
5	ATM	Anti-infective	221	218	236	24.6	(1.3)	8.1
6	Oxipod	Anti-infective	204	250	317	18.4	22.7	26.7
7	Cloben G	Dermatology	169	178	208	17.5	5.4	16.9
8	Senoform	Stomatological	182	174	181	25.5	(4.6)	4.3
Total			2,273	2,375	2,704	16.9	4.5	13.9
Domestic revenues			5,048	5,343	5,850			
% age of domestic revenues			45	44	46			

Source: Company, Nirmal Bang Institutional Equities Research

Productivity of medical representatives or MRs

As part of its efforts to rejuvenate domestic growth, IRL has increased the number of medical representatives. While the average field force productivity in the industry stands at Rs 5.2mn, in case of IRL it stood at Rs 2.1mn in FY17. Sales realisation per MR gradually improved from Rs 1.8mn in FY12 to Rs 2.1mn in FY17. The management is aware of its lower-than-average productivity in this segment and is working towards this metric.

Exhibit 10: MR growth trend

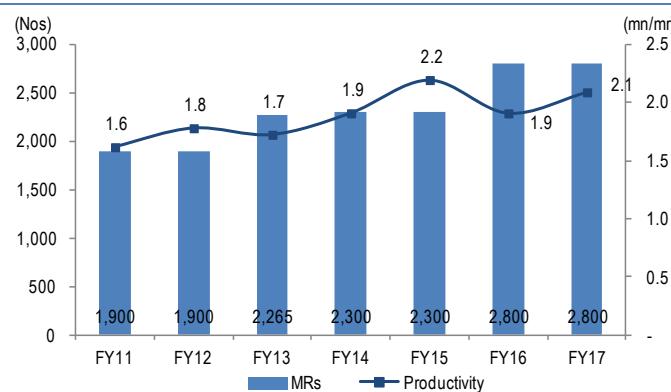
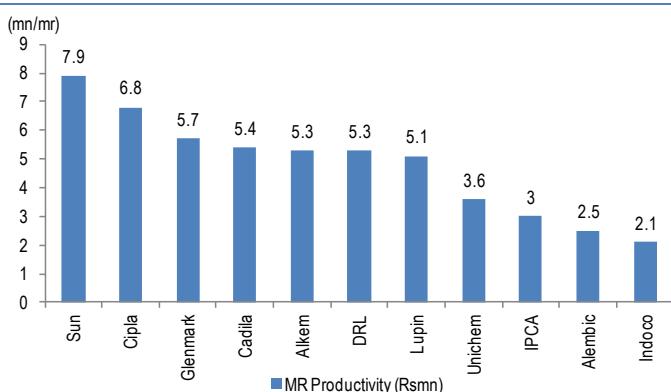


Exhibit 11: MR productivity (Rsmn) – IRL versus peers



Source: Company, Nirmal Bang Institutional Equities Research

Source: Company, Nirmal Bang Institutional Equities Research

Outlook

Going forward, a CAGR of 9% is expected (FY17 to FY20E) in domestic business on the back of the company's sustained efforts to improve MR productivity, foray into chronic therapies, new product launches mainly in cardiac and diabetic therapy segments, and growth in legacy brands.

International business

IRL's international business is spread across the globe, mainly in the US, Europe, South Africa, Australia and New Zealand and other emerging markets. The contribution to revenues has steadily increased from 33% in FY12 to 39% in FY17. IRL is working towards increasing this to 50%. Export revenues posted a CAGR of 17% over FY12 to FY17.

Exhibit 12: International revenues and growth

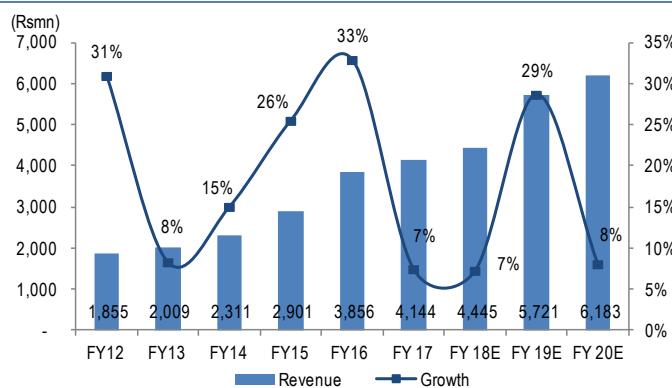
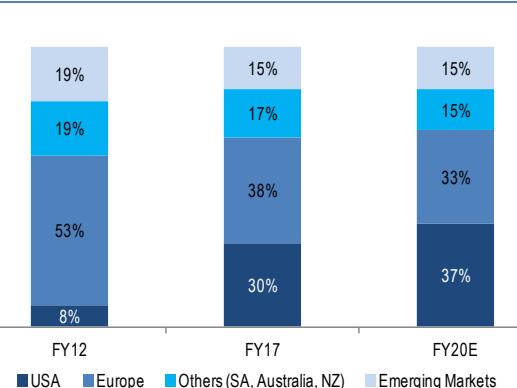


Exhibit 13: Geography-wise spread



Source: Company, Nirmal Bang Institutional Equities Research

Source: Company, Nirmal Bang Institutional Equities Research

US business

Revenues from the US posted double-digit YoY CAGR of 53% over FY12 to FY17. The growth fell from 50% in FY16 to 17% in FY17 because the company received Form 483 followed by a warning letter from the USFDA on account of which it chose to voluntarily stop supply of ophthalmic product Latanoprost to the US. This product is expected to generate sales of about Rs250mn. Additionally; this geography has been affected by customer consolidation, rising regulatory norms and costs, intense competition and increased pricing pressure.

Exhibit 14: US business - Revenue & growth trend

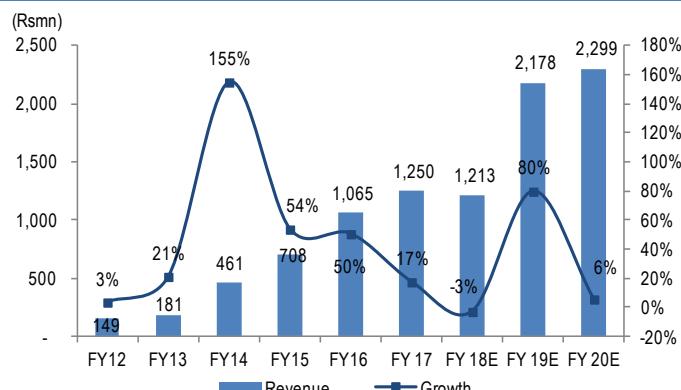
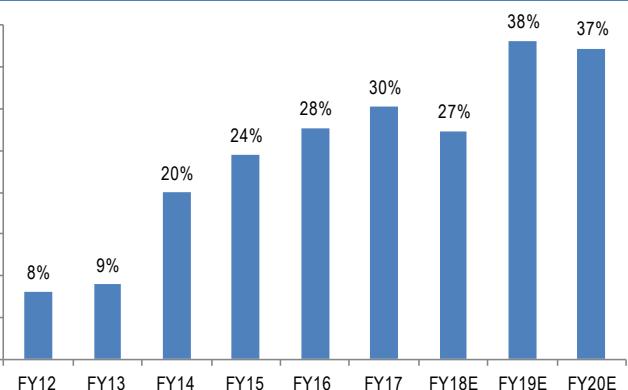


Exhibit 15: Contribution to export revenues



Source: Company, Nirmal Bang Institutional Equities Research

Source: Company, Nirmal Bang Institutional Equities Research

IRL operates on profit-sharing basis through a partnership model in the US. It has partnerships with Teva/Watson and recently started making filings on its own. The status of ANDAs filed is given below:

Exhibit 16: Status of ANDA filings

Particulars	Through Watson (Actavis)	Own filings	Through other customers	Total
Approvals till date	3	3	4	10
Tentative approvals	3	-	-	3
Filed, but pending approval	14	12	3	29
Total	20	15	7	42

Source: Company, Nirmal Bang Institutional Equities Research

Outlook

Going forward, in FY18, given the warning letter for Goa plant II and III, US revenues will be subdued as the company has discontinued supply of certain portfolio products as part of its remediation process. Going forward, in FY19 and FY20, we expect the company to come out of the warning letter. Revenues should ramp up on the basis of new launches, thus generating a growth of 80%/6%, respectively. IRL focuses on niche products in the ophthalmic and injectables space where there are only a few competitors, thus protecting revenues and margins.

New product launches in the US - ophthalmic and oral solids

The ophthalmic market in the US is a highly concentrated market, with top three players accounting for a disproportionate share of generic approvals that took place in this space. While Sandoz is the leader in this space with a market share of 42%, the other big players are Akorn and Bausch & Lomb (acquired by Valeant). The total market size is around US\$25bn, of which the generic market in the US contributes about US\$1.3bn. The median competitive intensity per ANDA stands at three to four players, which indicates that the price erosion in this space is relatively less steep. Thus, this remains to be an attractive space for companies to foray into, and offers good growth opportunities.

Exhibit 17: IRL's ophthalmic product portfolio/pipeline

Generic name	IMS sales	Patent expiry
Latanoprost Ophthalmic Solution	99	Expired
Olopatadine HCl Ophthalmic Solution	52	Expired
Olopatadine HCl Ophthalmic Solution	293	Expired
Bromfenac Sodium Ophthalmic Solution	121	Expired
Brinzolamide Ophthalmic Suspension	180	Expired
Azithromycin Ophthalmic Solution	19	2019
Gatifloxacin Ophthalmic Solution	28	Expired
Moxifloxacin Ophthalmic Solution	277	Expired

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 18: IRL's oral solids/injectable product pipeline

Potential ANDA filings	US sales (\$mn)	Expected generic entry
Febuxostat Tablets	380	June-2019
Pregabalin Capsules	3400	December-2018
Paracetamol + Tramadol Tablets	100	Patent expired
Solifenacin FC Tablets	530	October-2018
Neostogmine	100	Patent expired
Rasagiline Mesylate Tablets	340	Patent expired

Source: Company, Nirmal Bang Institutional Equities Research

Thus, IRL has considerable revenue growth opportunities from new product launches in the US which remains contingent on resolution of the warning letter issued by the USFDA on its Goa Plant II and III.

USFDA warning letter

USFDA had inspected the Goa plant of the company during the period 31 August 2016 to 4 September 2016. Goa plant II is involved in the manufacture of ophthalmic products and injectables, while Plant III makes tablets.

IRL was issued Form 483 by the USFDA with six observations, which the company duly responded to. While the USFDA accepted its replies towards four observations, it remained concerned about the balance two observations which led to the issue of a warning letter dated 27 March 2017.

The observations do not relate to data integrity but mainly revolves around lack of quality control and failure to follow the protocol for responding to complaints. Both these observations were related to the product Latanoprost which the company supplies on a contract manufacturing basis. The product sales are worth around Rs250mn per year.

Observation 1: Your firm failed to establish and follow adequate written procedures describing the handling of all written and oral complaints regarding a drug product.

During the period January 2012-August 2016, IRL received around 1,500 complaints relating to leaking, empty, and under-filled sterile solution bottles. This was because of a problem in the filling machine as a result of which either the defect was difficult to detect or in some cases cracks did not occur on the product immediately but some days later, probably even after the product was shipped.

While IRL has responded with improved process improvement in place and implementation of a new leak test, the USFDA remained unconvinced because the defects may occur some days after the product has been shipped, whereas the leak test will be undertaken at the production level.

Observation 2: Your firm has failed to ensure the responsibilities and procedures applicable to your quality control unit are followed.

IRL is required to notify its customers if it feels that any batch of distributed drug product should be subject to a field alert report (FAR). However, at the time of the USFDA inspection, there was no evidence of this being followed, although numerous complaints were received for multiple lots regarding leaking, empty, and under-filled bottles.

We discussed the warning letter with a regulatory consultant and he believes that the matter is resolvable with an effective CAPA, but it will need some minimum time. As the company has gone for a component change to remediate the leakage problem, it needs to conduct extractability and leachability studies which should take around four months for completion. According to him, the entire process for CAPA should take six to seven months. As none of the products manufactured by IRL comes under the shortage list, the USFDA can potentially take a longer time to come for a re-inspection.

We believe that IRL should get an EIR by the end of 1QFY19. The issues identified in the warning letter primarily pertain to strengthening the company's processes to ensure consistency and reliability in the quality of products that are being manufactured by IRL.

Assuming a successful resolution, not only will IRL be able to commence the supply of Latanoprost again, but it will also pave the way for approval of products in the pipeline which will lead to significant upside in stock price.

Europe

The revenues from this geography posted a CAGR of 10% over FY12 to FY17. Growth was flat in FY17 because of various challenges faced by this geography in the form of Brexit, currency depreciation, price cuts and increased focus on tender markets. IRL mainly operates in the UK, Germany and Spain and has started expanding into East Europe as well. The currency situation has improved in FY18 and IRL expects to return to double-digit growth during the year.

Exhibit 19: Europe revenues and growth

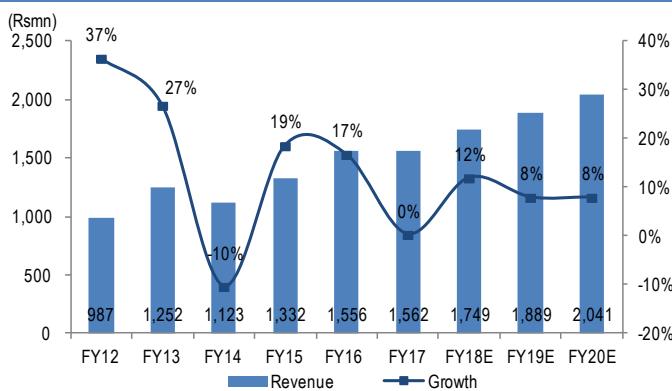
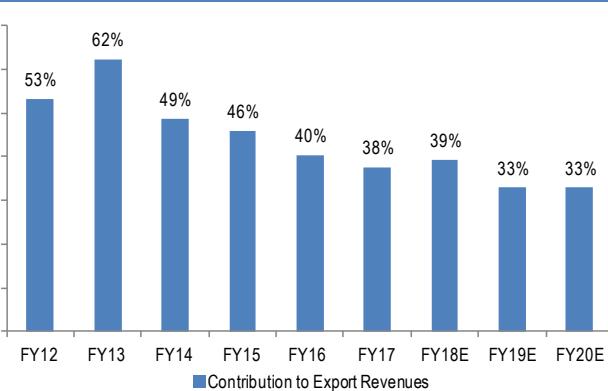


Exhibit 20: Contribution to export revenues



Source: Company, Nirmal Bang Institutional Equities Research

Source: Company, Nirmal Bang Institutional Equities Research

The business model for Europe includes CRAMs and out-licensing of dossiers & marketing authorisations (MA). The company has business collaboration with many companies. It also has a strategic business alliance (since 2013) with DSM Pharmaceutical for supply of eight APIs which are marketed in Europe.

IRL is set to introduce its own products, in addition to its existing CRAMs and dossiers/MAs. It has started own filings through DCP/MRP. In addition to solid orals, liquid orals and creams, IRL has now expanded its portfolio to Europe-specific injectables as well.

Exhibit 21: Status of dossier filings

	FY15	FY16	FY17
Approved till date (against those filed by customers)	17	17	22
Filed but pending approvals (includes own filings)	10	9	17
Total	27	26	39

Source: Company, Nirmal Bang Institutional Equities Research

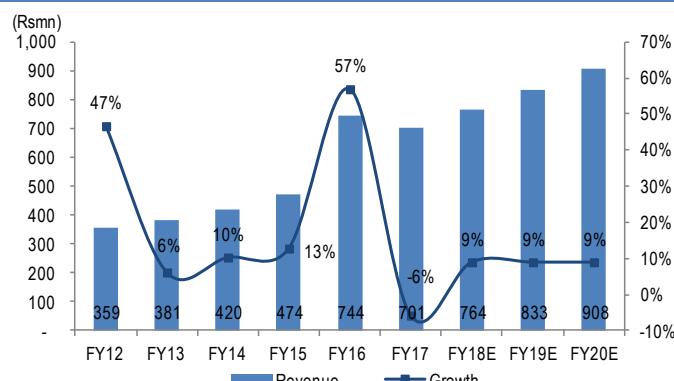
Outlook

The company continues to file products to expand its base in Europe. IRL has been expanding its filing base and in addition the company is also focusing on niche products and will be owning the dossiers that it gains approvals for. The strategy should help the company expand its revenue base in Europe. We expect high single-digit growth in European business for IRL.

South Africa, Australia & New Zealand

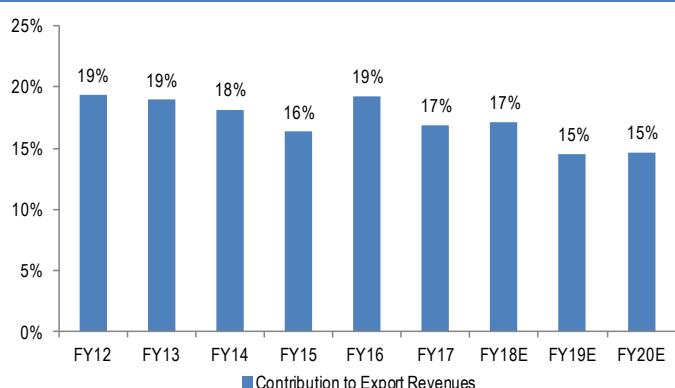
The growth in these geographies has not been stable, but the contribution to revenues remained in the range of 16%-19% of export revenues. These geographies posted a CAGR of 14% over FY12 to FY17. IRL works in these geographies through a partnership model. It has signed a deal with Aspen for supply of products in these areas. Going forward, we expect the revenues to post a CAGR of 9%.

Exhibit 22: South Africa, Australia & New Zealand - Revenues & growth



Source: Company, Nirmal Bang Institutional Equities Research

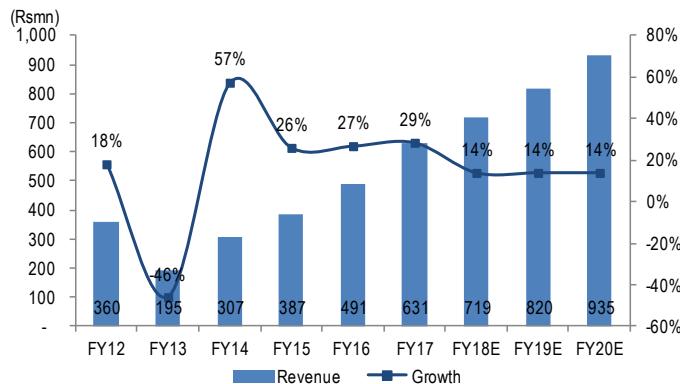
Exhibit 23: Contribution to export revenues



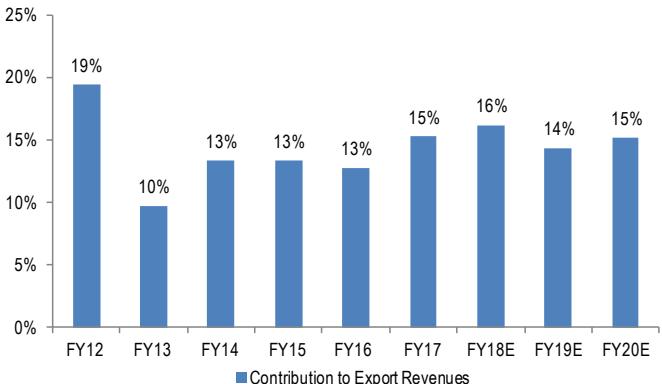
Source: Company, Nirmal Bang Institutional Equities Research

Emerging markets

IRL operates in countries like Kenya, Tanzania, Sri Lanka and Myanmar. The company has also forayed into new markets like Zambia, Cameroon & Ethiopia. Double-digit growth has been witnessed from FY15 and a CAGR of 12% has been recorded from FY12 to FY17. IRL has signed an agreement with Hemas Pharma which is the top distributor in Sri Lanka. This tie-up is expected to further strengthen the distributor network of IRL which will aid in pushing secondary sales for Hemas Pharma. We forecast 14% growth for IRL in emerging markets.

Exhibit 24: Emerging markets - Revenue and growth


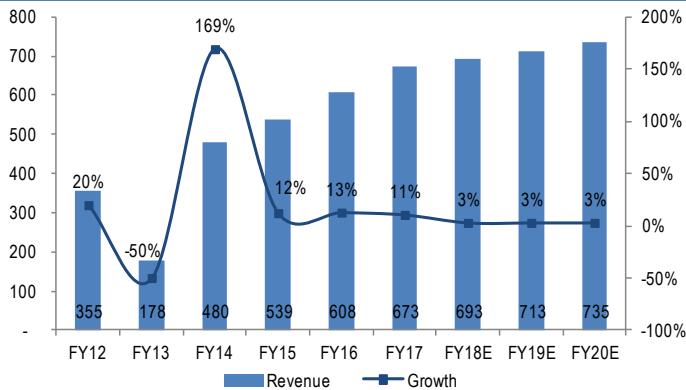
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 25: Contribution to export revenues


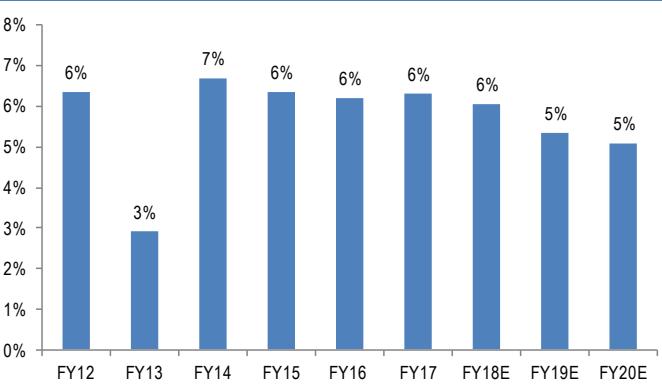
Source: Company, Nirmal Bang Institutional Equities Research

API business

IRL has been involved in the API business mainly for the benefits of backward integration, with its main focus on formulations – domestic and export markets. While this segment has consistently shown double-digit growth since FY14, it continues to account for a small portion of revenues, contributing around 6% to total revenues. This segment posted five-year CAGR of 14% up to FY17 and going forward we expect CAGR of 3% over a three-year period from FY17 to FY20E.

Exhibit 26: API business - Revenues and Growth


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 27: Contribution to total revenues


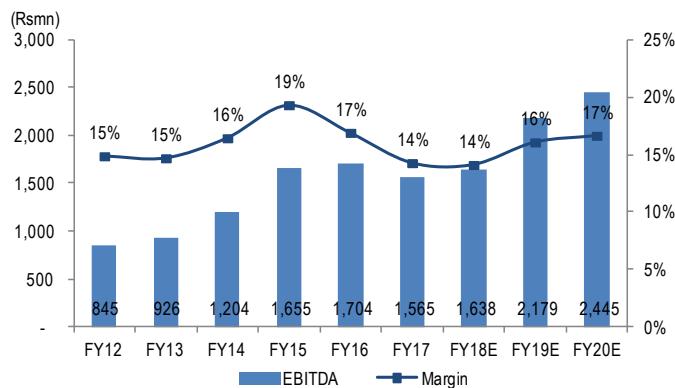
Source: Company, Nirmal Bang Institutional Equities Research

Earnings performance

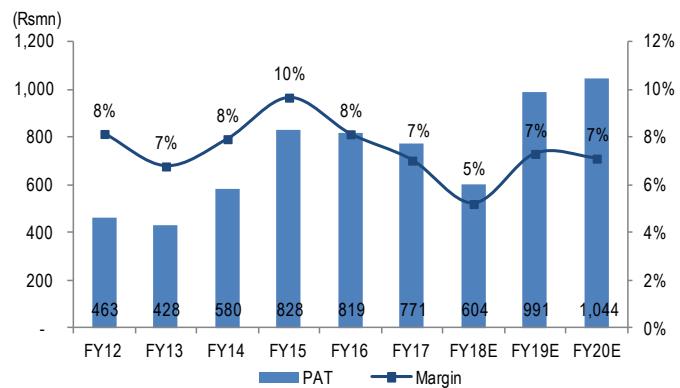
Gross margin remained in the range of 63%-65% from FY14 to FY17 and is expected to follow the same trend over FY18 and decline by 100bps in FY19 and FY20 on account of new high value product launches in the US.

Similarly, EBITDA margin is expected to be 14% in FY18 and rise to 16%/17% in FY19 and FY20 on account of incremental revenues and slower growth in employee costs (as the company does not intend to increase hiring significantly) and other expenses. Research and development or R&D expenses are expected to remain constant at 5% of sales.

PAT margin is expected to fall to 5% in FY18 on account of lower US sales and subsequently rise to 7% in FY19 and FY20.

Exhibit 28: EBITDA and margins


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 29: PAT and margins


Source: Company, Nirmal Bang Institutional Equities Research

Valuation

We have valued IRL on forward EV/EBITDA - FY19, using a weighted average multiple for each geography / business segment in which the company operates in. Accordingly, we have arrived at a target price of Rs250, representing an upside of 29% from the current market price of Rs194. IRL offers an attractive risk-reward profile as we see the fixed costs related to the US business - which is yet to gain critical mass - is adversely impacting earnings performance. An untimely warning letter by the USFDA has already knocked off some time-sensitive high-value opportunities which the company could not capitalise upon. However, we believe that the company's focus on ophthalmic segment and the decision to be backward integrated for most ANDA filings in the US should allow the company to build up its US business to a critical size which should allow a jump in earnings from the current level once the warning letter problem is resolved. Our discussions with regulatory consultants suggest that the issues can be resolved, but requires a very effective CAPA to be implemented. We believe the resolution should happen latest by the end of 1QFY19. Our forecast on the US business currently assumes 60% probability of a resolution.

Exhibit 30: Valuation multiple – US

Sr. No.	Companies	Market cap. (US\$mn)	FY19/CY18 EV/EBITDA	Weights	Weighted average
1	Mylan	16,405	7.3	32%	2.3
2	Teva	15,692	8.4	30%	2.5
3	Aurobindo	6,728	10.3	13%	1.3
4	Taro	4,597	9.3	9%	0.8
5	Valeant	4,146	7.2	8%	0.6
6	Akorn	4,101	14.6	8%	1.2
			51,669	100%	8.8
Average		9.5			
Weighted average		8.8			

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 31: Valuation multiple – India

Sr. No.	Companies	Market cap. (US\$mn)	FY19 ; CY18 EV/EBITDA	Weights	Weighted average
1	Alkem	3,330	12.9	40%	5.2
2	Sanofi	1,465	13.6	18%	2.4
3	Abbot	1,392	12.5	17%	2.1
4	Pfizer	1,297	13.2	16%	2.1
5	FDC	469	7.8	6%	0.4
6	Unichem	351	8.1	4%	0.3
			8,304	100%	12.5
Average		11.4			
Weighted average		12.5			

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 32: Valuation multiple – Europe

Sr. No.	Companies	Market cap. (USD Mn)	FY19 ; CY18 EV/EBITDA	Weights	Weighted average
1	Stada	5,863	13.2	54%	7.2
2	Geodeon Richter	4,838	10.3	45%	4.6
3	Concordia	64	9.7	1%	0.1
		10,765		100%	11.9
Average		11.1			
Weighted average		11.9			

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 33: Valuation multiple – API & others

Sr. No.	Companies	Market cap. (USD Mn)	FY19 ; CY18 EV/EBITDA	Weights	Weighted average
1	Divis	2,922	11.8	66%	7.8
2	Laurus	870	9.8	20%	1.9
3	Granules	453	7.7	10%	0.8
4	Neuland	189	8.0	4%	0.3
		4,434		100%	10.8
Average		9.3			
Weighted average		10.8			

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Valuation scenarios
Exhibit 34: Scenario description

Particulars	Scenario
Bear case scenario	We assume that IRL fails to receive EIR for its Goa plant II and III facilities, thus leading to no new product approvals. Only revenues from the base business will be generated, which are also prone to price erosion. Accordingly, adjustments have been made to the revenues and EBITDA for this scenario. R&D spend has been considered at 50% of the total R&D spend forecasted for FY19.
Base case scenario	We assume a 60% probability of IRL receiving EIR in the second-half of the year. It will be able to maintain its base business (subject to price erosion) and generate about 50%-60% of the forecasted revenues from new product launches.
Best case scenario	We assume successful resolution of the Warning Letter in the second-half of the year. It will be able to maintain its base business (subject to price erosion) and garner 100% of forecasted US revenues from new product launches.

Source: Nirmal Bang Institutional Equities Research

Exhibit 35: Valuation under three scenarios (Rsmn)

Valuation (Rsmn)	Bear case	Base case	Best case
Enterprise value	22,280	24,520	29,068
Less: Net debt	1,515	1,515	1,515
Equity value	20,764	23,005	27,553
No of shares (mn)	92	92	92
Value per share (Rs)	225	250	299
CMP per share (Rs)	194	194	194
Upside (%)	16	29	54

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 36: EV under base case scenario

Geography	Sales (Rsmn)	% of sales	EBITDA (Rsmn)	% of sales	EV (Rsmn)	EV/EBITDA (x)	Sector prem./disc. (%)	Adj. EV/EBITDA
India formulations	6,887	52	1,240	18	15,528	12.5	-	12.5
Exports - US	2,178	16	323	15	2,828	8.8	-	8.8
Exports - Europe	1,889	14	283	15	2,697	11.9	20	9.5
Exports- Others	833	6	125	15	1,348	10.8	-	10.8
Exports - Emerging	820	6	123	15	1,195	10.8	10	9.7
API&CRO	713	5	86	12	924	10.8	-	10.8
Total	13,321		2,179	16	24,520			

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 37: EV under bear case scenario

Geography	Sales (Rsmn)	% of sales	EBITDA (INR Mn)	% of sales	EV (Rsmn)	EV/EBITDA (x)	Sector prem./disc. (%)	Adj. EV/EBITDA
India formulations	6,887	52	1,240	18	15,528	12.5	-	12.5
Exports - US	1,176	10	67	6	588	8.8	-	8.8
Exports - Europe	1,889	15	283	15	2,697	11.9	20%	9.5
Exports - Others	833	7	125	15	1,348	10.8	-	10.8
Exports - Emerging	820	7	123	15	1,195	10.8	10	9.7
API&CRO	713	6	86	12	924	10.8	-	10.8
Total	12,319		1,924	16	22,280			

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 38: EV under best case scenario

Geography	Sales (Rsmn)	% of sales	EBITDA (Rsmn)	% of sales	EV (Rsmn)	EV/EBITDA (x)	Sector prem./disc. (%)	Adj. EV/EBITDA
India formulations	6,887	48	1,240	18	15,528	12.5	-	12.5
Exports - US	3,147	22	842	27	7,376	8.8	-	8.8
Exports - Europe	1,889	13	283	15	2,697	11.9	20	9.5
Exports - Others	833	6	125	15	1,348	10.8	-	10.8
Exports - Emerging	820	6	123	15	1,195	10.8	10	9.7
API&CRO	713	5	86	12	924	10.8	-	10.8
Total	13,321		2,699	16	29,068			

Source: Company, Nirmal Bang Institutional Equities Research

Company overview

Founded by Mr. Govind Kare and incorporated on 23 August 1947, Indoco Remedies is a fully integrated, research-oriented pharmaceutical company with a global presence in 55 countries. It is mainly involved in the manufacture and marketing of formulations and active pharmaceutical ingredients (APIs).

The company operates in domestic as well as international markets through different business models. Domestic formulations contribute to about 55% of revenues, with 39% coming from international formulations and 6% from APIs.

In India, it operates through 10 marketing divisions and caters to a range of therapy specialties. It has about 2,800 medical representatives or MRs. It is a leader in the oral care space with products like Sensodent and Sensoform. Its other popular brands are Febrex, Cycopalm, Cital and Homide.

In international markets, it operates mainly on a profit-sharing basis with partner tie-ups. It has collaborations with Watson (US), Aspen (South Africa, Australia, New Zealand) and DSM (Europe). It is now going ahead with own filings in international markets.

Key management personnel

Mr. Suresh Kare - Chairman: Mr. Kare has been at the helm of the company's affairs for over 50 years and has transformed it into the organisation that it is today. He holds a Bachelors in Science degree from Mumbai University and is well respected by the industry for his acute business acumen and vision. He has been the president of the Indian Drug Manufacturers Association (IDMA) and has significantly contributed to the growth of the Indian pharmaceutical industry.

Ms. Aditi Kare Panandikar - Managing Director: Ms Panandikar holds a Bachelors Degree in Pharmacy and a Masters Degree in Pharmaceutical Administration from the Ohio State University, USA. She has also pursued in-depth study in patent law and practices. Prior to her current stint as MD, she successfully headed key departments within the organisation. Ms. Panandikar received the 'Leader Of The Year' award at the UBM India Pharma Awards in 2016, 'Business Woman Of The Year' award at the Business Goa Awards for Corporate Excellence 2016 and 'Jack L. Beal Post-baccalaureate Alumni' award from the Ohio State University for her outstanding contribution to the pharmaceutical industry in May 2015.

Mr. Sundeep V. Bambolkar – Joint Managing Director: Mr. Bambolkar has a Bachelors Degree in Science, Post Graduate Diploma in Entrepreneurship Management and Masters in Administrative Management (MAM). He has also undergone a Management Development Programme at the Kellogg School of Management, Chicago, USA. Prior to his appointment as joint MD, he headed departments such as finance, operations, purchase, projects and international business within Indoco Remedies. As the joint MD, he is responsible for the overall management of the company with special focus on international business, operations and finance. Recipient of an award in the category 'Winning Edge in Cost Management' initiated by CFO 100 Institute, 9.9 media for two consecutive years, 2011 & 2012.

Exhibit 39: Shareholding pattern

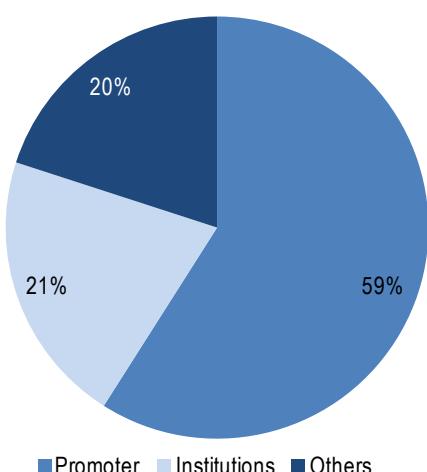


Exhibit 40: Top 10 shareholders

Sr No.	Holder Name	% age holding
1	Spa Holdings Pvt Ltd	20
2	Shanteri Investment Pvt Ltd	17
3	Commonwealth Bank Of Australia	10
4	Panandikar Aditi Milind	6
5	Anup Ramani Madhura	6
6	Kare Aruna Suresh	5
7	Kare Suresh Govind	5
8	Dsp Blackrock Investment Manager	3
9	Barclays Mercantile Bank	3
10	IDFC Mutual Fund	2

Source: BSE

Source: Bloomberg

Exhibit 41: Peer analysis

Company	CMP (Rs)	Market Cap (US\$mn)	P/E (X)			EV/EBITDA (X)			CAGR		
			FY17	FY18E	FY19E	FY17	FY18E	FY19E	Sales	EBITDA	EPS
Indoco	194	279	23.2	29.6	18.0	12.7	12.0	8.9	11%	18%	13%
Alkem	1,801	3,362	26.0	19.4	16.6	20.1	15.5	13.2	15%	23%	25%
Sanofi	4,010	1,442	31.1	29.1	25.1	18.3	16.2	13.6	8%	8%	11%
Abbot	4,242	1,407	35.3	24.1	19.4	17.4	15.6	12.4	21%	24%	35%
Pfizer	1,822	1,301	24.8	29.6	24.6	20.9	15.4	13.3	10%	22%	0%
FDC	168	468	15.9	15.1	13.0	13.0	8.8	7.8	11%	16%	10%
Unichem	241	342	20.2	15.5	11.8	15.0	10.1	7.9	17%	27%	31%

Source: Company, Nirmal Bang Institutional Equities Research

Financial statements

Exhibit 42: Income statement

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Net sales	10,081	10,968	11,611	13,560	14,688
% growth	17.6	8.8	5.9	16.8	8.3
Raw material costs	3,500	3,833	4,103	4,822	5,242
Staff costs	1,819	2,167	2,383	2,622	2,884
R&D	432	517	547	639	692
Other expenditure	2,627	2,886	2,940	3,298	3,425
Total expenditure	8,377	9,403	9,974	11,381	12,243
EBITDA	1,704	1,565	1,638	2,179	2,445
% growth	3.0	(8.2)	4.7	33.1	12.2
EBITDA margin (%)	16.9	14.3	14.1	16.1	16.6
Other income	16	40	63	50	57
Interest costs	124	62	244	226	225
Gross profit	6,581	7,135	7,508	8,738	9,446
% growth	18.3	8.4	5.2	16.4	8.1
Depreciation	607	633	682	733	785
Profit before tax	989	909	775	1,270	1,491
% growth	(9.7)	(8.1)	(14.8)	63.9	17.4
Tax	170	139	170	279	447
Effective tax rate (%)	17.2	15.3	22.0	22.0	30.0
Net profit	819	771	604	991	1,044
% growth	(1.1)	(6.0)	(21.6)	63.9	5.4
EPS (Rs)	8.9	8.4	6.6	10.8	11.3
% growth	(1.1)	(6.0)	(21.6)	63.9	5.4

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 44: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Equity	184	184	184	184	184
Reserves	5,581	6,331	6,758	7,571	8,437
Net worth	5,765	6,516	6,942	7,755	8,621
Provisions/ other LT liabilities	168	223	244	271	297
Total loans	1,316	2,577	2,249	2,082	2,082
Liabilities	7,249	9,315	9,435	10,108	11,000
Net block	3,344	3,928	4,372	4,811	5,199
Capital work-in-progress	58	403	450	450	450
Intangible assets	393	473	368	263	158
LT loans & advances	13	14	14	14	14
Other LT assets	953	1,427	1,144	977	809
Inventories	1,667	1,869	2,001	2,352	2,556
Debtors	1,888	2,157	2,283	2,667	2,888
Cash	126	626	496	567	1,091
Other current assets	964	1,073	1,135	1,325	1,435
Total current assets	4,646	5,725	5,916	6,910	7,971
Trade payables	1,313	1,640	1,756	2,064	2,243
Other current liabilities/provisions	844	1,014	1,074	1,254	1,358
Total current liabilities	2,157	2,654	2,830	3,318	3,601
Net current assets	2,488	3,070	3,086	3,593	4,370
Total assets	7,249	9,315	9,435	10,108	11,000

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 43: Cash flow

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
EBIT	1,113	972	1,018	1,496	1,717
(Inc.)/dec. in working capital	(373)	(239)	(146)	(436)	(252)
Cash flow from operations	740	732	873	1,060	1,464
Other income	(16)	(40)	(63)	(50)	(57)
Depreciation	607	633	682	733	785
Interest	(124)	(62)	(244)	(226)	(225)
Tax paid (-)	(170)	(139)	(170)	(279)	(447)
Net cash from operations	1,037	1,124	1,078	1,239	1,520
Capital expenditure (-)	(573)	(1,290)	(900)	(900)	(900)
Net cash after capex	465	(165)	178	339	620
Other investing activites	(333)	(631)	177	50	57
Cash from Financial Activities	(159)	1,296	(485)	(317)	(152)
Change in Cash	(28)	500	(130)	71	525
Opening cash balance	154	126	626	496	567
Closing cash balance	126	626	496	567	1,091

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 45: Key ratios

Y/E March	FY16	FY17	FY18E	FY19E	FY20E
Profitability & return ratios					
EBITDA margin (%)	16.9	14.3	14.1	16.1	16.6
EBIT margin (%)	10.9	8.5	8.2	10.7	11.3
Net profit margin (%)	8.1	7.0	5.2	7.3	7.1
RoE (%)	14.2	11.8	8.7	12.8	12.1
RoCE (%)	21.6	14.0	14.5	21.3	22.4
Working capital & liquidity ratios					
Receivables (days)	62.3	67.3	69.8	66.6	69.0
Inventory (days)	164.7	168.4	172.2	164.7	170.9
Payables (days)	131.0	140.6	151.1	144.6	150.0
Current ratio (x)	96.0	95.1	90.9	86.8	90.0
Quick ratio (x)	2.2	2.2	2.1	2.1	2.2
Valuation ratios					
EV/sales (x)	1.4	1.5	1.4	1.4	1.5
EV/EBITDA (x)	1.9	1.8	1.7	1.4	1.3
P/E (x)	11.1	12.7	12.0	8.9	7.7
P/BV (x)	21.8	23.2	29.6	18.0	17.1

Source: Company, Nirmal Bang Institutional Equities Research

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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