

Q2FY20 RESULT UPDATE | PHARMACEUTICALS

Indoco Remedies

PAT missing estimates, long road ahead

Indoco missed our PAT estimates by 20% despite in-line sales and EBITDA performance, which were dragged by a higher tax rate. While sales growth was encouraging at 21% YoY, led by seasonality, improved productivity in India, and healthy exports performance, the management guided for EBITDA in the range of Rs1.1–1.25bn, in line with our estimates. The guidance is backed by 15% sales growth in India and 30% in export formulations for FY20E. Though product sales have not achieved normalcy in the US (growth led by milestone payments) and the UK (expected to improve as Goa Plant 1 has received compliant status from UK MHRA), the management remains fairly confident of traction in sales by end of FY21E.

Indoco's export business in regulated markets is largely CRAMS-based with higher dependency on partners, but it remains confident of capitalizing its relationship with its partners for sales ramp up. We believe this could be a slow process as contracts get renewed with both existing and new partners, and supply resumes at levels prior to the warning letter stage. We expect sales to register a 13% CAGR over FY19–21E, with EBITDA margin improving to 11.5–13.8% on a lower base until the capacity utilization for exports plays out. Although the past few months have seen favourable progress in the compliance situation, we believe the company still needs about two years to regain the peak levels of business performance. At the CMP, the stock trades at 20.5x FY21E EPS of Rs8. Maintain SELL.

2QFY20 Result Snapshot: Q2 performance was below expectations despite in-line sales (up 21% YoY) and EBITDA margin at 11.2% (up 230 bps QoQ and 170 bps YoY), primarily due to a higher tax rate. Domestic sales (up 17% YoY) were led by seasonality, while exports (up 40% YoY) reported a sharp jump due to milestone payments in the US and resumption of sales in the UK.

Financial Summary

Rs. Mn	Mar 17	Mar 18	Mar 19	Mar 20E	Mar 21E
Net sales	10,694	10,210	9,421	10,956	12,581
EBITDA	1,565	1,349	766	1,289	1,781
Adj. PAT	771	412	(26)	368	713
Adj. EPS (Rs.)	8.4	4.5	(0.3)	4.0	7.7
EBITDA Margin (%)	14.3	12.9	7.9	11.5	13.8
ROE	12.6	6.2	(0.4)	5.4	9.8
Adj. P/E (x)	30	36	(559)	40	21
EV/EBITDA (x)	16.3	16.7	23.2	13.6	9.8

Source: Company, IndiaNivesh institutional Research

SELL

CURRENT PRICE (INR)

159

UPSIDE/DOWNSIDE

▼ (36)%

TARGET PRICE (INR)

100

PREVIOUS TARGET (INR)

100

(CMP as on 30 Oct 2019 closing)

STOCK INFO

BSE	532612
NSE	INDOCO
Bloomberg	INDR IN
Reuters	INRM.NS
Face Value (Rs)	2
Equity Capital (Rs mn)	184
Mkt Cap (Rs mn)	14,693
52wk High/Low	239 / 132
Avg Daily Vol (BSE+NSE)	77,810

SHAREHOLDING PATTERN (%)

Promoters	58.69
Public	41.31

(as on Sep, 2019)

PRICE PERFORMANCE



STOCK PERFORMANCE

	3m	6m	12m
Indoco Remedies	2.0	(20.2)	(14.8)
SENSEX	7.1	2.6	18.2

Source: Bloomberg, IndiaNivesh Institutional Research

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Key takeaways from the conference call:

- **US business:** Sales in Q2 saw a 113% YoY jump at Rs111mn, led by certain milestone payments. The management expects supply-related sales to ramp up from Q4 onwards, as it is currently in negotiations for its product basket returned from Teva. Currently, of the 24 sterile products, the company has launched 11 and has 2 approved products. It expects the US to sustain the existing quarterly run rate. The company has guided to file 2-3 products in FY20E and 5-6 products in FY21E.
- **Domestic formulations:** Sales grew 17% YoY led by strong volume growth of 11% followed by 4% price growth and 2% from new launches in Q2. The management has guided for 15% revenue growth in FY20 vs low double-digit growth guided earlier, on the back of improved productivity witnessed in Q2. Focus remains on stomatological, respiratory, and gastro therapies in both existing and new launches. Current MR productivity has improved to Rs2.5mn from Rs2.3mn PCPM YoY.
- **Export formulations guided to grow 30% YoY:** The management guided for a healthy 30% YoY growth in export formulations in FY20E led by traction in Europe. The management is of the view that it could capitalize on its relationship with partners in Europe to ramp up sales. While company could achieve 2.5x of current sales in Europe with its existing capacity, it would take ~6-8 quarters to reach there.
- **UK:** Upon receipt of GMP compliance status for the Goa Plant I, the management remains confident of higher procurement from its large clients and expects sales of Rs1.8–2bn in FY20E.
- **API:** The management guided for sales of Rs1bn in FY20E, in line with our estimates. The company has tripled its capacity with the new API plant at Patalganga and remains confident of 35% YoY growth.
- **Financials:**
 - **Capex:** Should be ~Rs500mn each for FY20 and FY21E.
 - **Remediation costs:** Company spent ~Rs50mn in FY19 and expects ~Rs40–45mn expenditure in FY20E.
 - **Cost of debt:** -7.5%, company is fully hedged.

Exhibit 1: Q2FY20 financial highlights

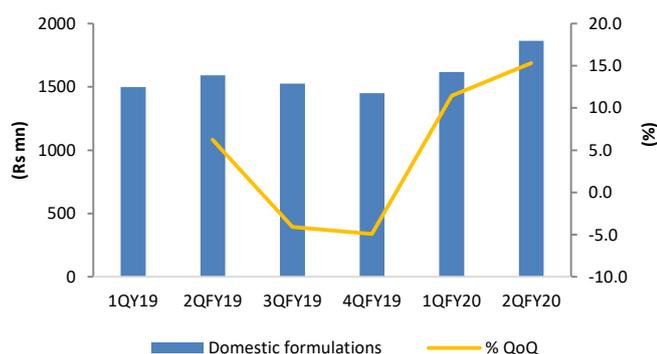
Rs mn	2QFY19	2QFY20	YoY (%)	1QFY20	QoQ (%)	H1FY19	H1FY20	YoY (%)	FY19	FY20E	YoY (%)	FY21E	YoY (%)
Net Sales	2363	2862	21.1	2472	15.8	4488	5334	18.9	9421	10956	16.3	12581	14.8
Expenses	2238	2599	16.1	2303	12.9	4298	4902	14.1	8918	9937	11.4	11079	11.5
Operating profit	124	263	111.5	169	55.3	190	432	127.9	503	1019	102.6	1501	47.4
Other operating income	-3	64	2293.1	55	15.6	48	119	149.7	264	271	2.7	280	3.2
EBITDA	121	326	169.0	224	45.5	237	551	132.3	766	1289	68.2	1781	38.1
EBITDA Margin (%)	5.1	11.2		8.9		5.2	10.1		7.9	11.5		13.8	
Other income	3	6	70.6	6	-9.4	7	12	87.7	61	55	-10.7	52	-4.4
Depreciation	176	180	2.3	170	6.2	344	350	1.9	716	694	-3.1	710	2.3
Interest	50	54	7.2	61	-12.3	122	115	-5.7	205	233	13.3	221	-5.1
PBT	-102	98	196.3	0	-	-222	97	143.9	-93	418	548.8	903	116.0
Tax expense	-27	20	172.9	-19	204.7	-27	1	103.3	-67	50	175.3	190	276.6
Tax rate (%)	27	20		3800		12	1		72	12		21	
Reported PAT	-75	78	204.8	19	322.2	-195	97	149.6	-26	368	1501.9	713	94.0

Source: Company, IndiaNivesh Institutional Research

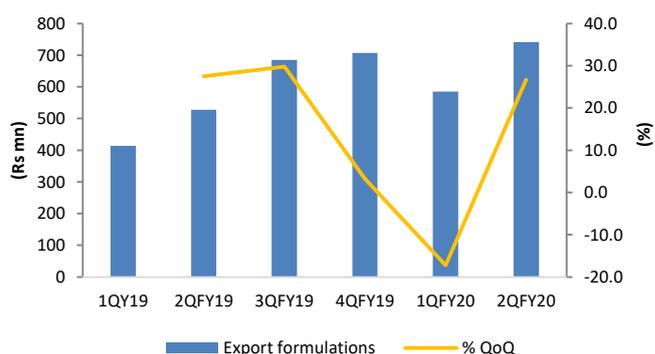
Exhibit 2: Revenue mix

Rs mn	2QFY19	2QFY20	YoY (%)	1QFY20	QoQ (%)	H1FY19	H1FY20	YoY (%)
Formulations	2168	2622	21.0	2227	17.8	4134	4849	17.3
Domestic	1590	1863	17.2	1616	15.3	3087	3479	12.7
Export	528	741	40.4	585	26.6	942	1327	40.8
CRO	50	18	-63.8	26	-29.7	106	44	-58.7
API	191	234	22.2	237	-1.6	349	471	34.9
Total	2359	2856	21.1	2464	15.9	4483	5320	18.7

Source: Company, IndiaNivesh Institutional Research

Exhibit 3: Improving trajectory in India - led by seasonality and improving productivity

Source: Company, IndiaNivesh Institutional Research

Exhibit 4: Exports remain volatile clamped down by regulatory issues

Source: Company, IndiaNivesh Institutional Research

Income statement (consolidated)

Period end (Rs mn)	Mar 17	Mar 18	Mar 19	Mar 20E	Mar 21E
Net sales	10,694	10,210	9,421	10,956	12,581
Growth (%)	9%	-5%	-8%	16%	15%
Operating expenses	(9,403)	(9,104)	(8,918)	(9,937)	(11,079)
Operating profit	1,291	1,107	503	1,019	1,501
Other operating income	274	243	264	271	280
EBITDA	1,565	1,349	766	1,289	1,781
Growth (%)	-8%	-14%	-43%	68%	38%
Depreciation	(633)	(677)	(716)	(694)	(710)
Other income	40	47	61	55	52
EBIT	971	719	112	651	1,124
Finance cost	(62)	(235)	(205)	(233)	(221)
Exceptional & extraordinary	0	0	0	0	0
Profit before tax	909	484	(93)	418	903
Tax (current + deferred)	(139)	(72)	67	(50)	(190)
P / L form discontinuing operations	0	0	0	0	0
Profit / (Loss) for the period	771	412	(26)	368	713
P/L of Associates, Min Int, Pref Div	0	0	0	0	0
Reported Profit / (Loss)	771	412	(26)	368	713
Adjusted net profit	771	412	(26)	368	713
Growth (%)	-6%	-47%	-106%	1502%	94%

Source: Company, IndiaNivesh institutional Research

Balance sheet (consolidated)

Period end (Rs mn)	Mar 17	Mar 18	Mar 19	Mar 20E	Mar 21E
Share capital	184	184	184	184	184
Reserves & surplus	6,329	6,566	6,422	6,815	7,335
Shareholders' funds	6,513	6,750	6,606	6,999	7,519
Minority Interests and others	0	0	0	0	0
Non-current liabilities	1,550	1,456	1,519	1,460	1,416
Long-term borrowings	1,323	1,233	1,287	1,199	1,120
Other non-current liabilities	227	223	233	261	295
Current liabilities	3,904	4,174	4,455	4,128	4,356
ST borrowings, Curr maturity	1,184	1,099	1,134	733	733
Other current liabilities	2,720	3,074	3,321	3,396	3,623
Total (Equity and Liabilities)	11,967	12,379	12,580	12,587	13,291
Non-current assets	6,247	6,990	7,200	7,046	6,981
Fixed assets (Net block)	5,304	6,243	6,530	6,315	6,168
Non-current Investments	0	0	0	0	0
Long-term loans and advances	185	227	156	182	209
Other non-current assets	480	205	158	158	173
Current assets	5,721	5,390	5,381	5,541	6,310
Cash & current investment	626	119	363	221	376
Other current assets	5,095	5,271	5,018	5,320	5,934
Total (Assets)	11,967	12,379	12,580	12,587	13,291
Total debt	3,191	3,355	3,514	3,134	3,176
Capital employed	9,932	10,328	10,353	10,394	10,991

Source: Company, IndiaNivesh institutional Research

Cash flow statement (consolidated)

Period end (Rs mn)	Mar 17	Mar 18	Mar 19	Mar 20E	Mar 21E
Profit before tax	909	484	(93)	418	903
Depreciation	633	677	716	694	710
Change in working capital	(481)	(188)	532	(342)	(507)
Total tax paid	(196)	(110)	25	(86)	(229)
Others	62	235	205	233	221
Cash flow from oper. (a)	928	1,099	1,385	916	1,098
Capital expenditure	(1,656)	(1,616)	(1,002)	(479)	(563)
Change in investments	157	0	0	0	0
Others	(283)	275	47	0	(16)
Cash flow from inv. (b)	(1,782)	(1,341)	(955)	(479)	(578)
Free cash flow (a+b)	(854)	(242)	430	438	520
Equity raised/(repaid)	(2)	0	0	0	0
Debt raised/(repaid)	1,418	163	159	(380)	41
Dividend (incl. tax)	(178)	(111)	7	(99)	(193)
Others	115	(317)	(353)	(101)	(213)
Cash flow from fin. (c)	1,353	(265)	(187)	(580)	(364)
Net chg in cash (a+b+c)	500	(507)	244	(142)	155

Source: Company, IndiaNivesh institutional Research

Key ratios (consolidated)

Period end (%)	Mar 17	Mar 18	Mar 19	Mar 20E	Mar 21E
Adjusted EPS (Rs)	8.4	4.5	(0.3)	4.0	7.7
Growth	-6%	-47%	-106%	1502%	94%
CEPS (Rs)	15.2	11.8	7.5	11.5	15.4
Book NAV/share (Rs)	70.7	73.2	71.7	76.0	81.6
Dividend/share (Rs)	1.6	1.0	(0.1)	0.9	1.7
Dividend payout ratio	23.1	27.0	27.0	27.0	27.0
EBITDA margin	14.3	12.9	7.9	11.5	13.8
EBIT margin	9.1	7.0	1.2	5.9	8.9
Tax rate	15.3	15.0	71.8	12.0	21.0
RoCE	11.0	7.1	1.1	6.3	10.5
Total debt/Equity (x)	0.5	0.5	0.5	0.4	0.4
Net debt/Equity (x)	0.4	0.5	0.5	0.4	0.4
Du Pont Analysis - ROE					
Net margin	7.2	4.0	(0.3)	3.4	5.7
Asset turnover (x)	1.0	0.8	0.8	0.9	1.0
Leverage factor (x)	1.7	1.8	1.9	1.8	1.8
Return on equity	12.6	6.2	(0.4)	5.4	9.8
Valuation (x)					
PER	29.8	35.6	(558.8)	39.9	20.5
PCE	16.4	17.8	21.3	13.8	10.3
Price/Book	3.5	2.9	2.2	2.1	1.9
Yield (%)	0.6	0.5	(0.0)	0.6	1.1
EV/EBITDA	16.3	16.7	23.2	13.6	9.8

Source: Company, IndiaNivesh institutional Research