Stock Update

Strong outlook for 2-3 years; re-initiate Buy with TP of Rs 1,135

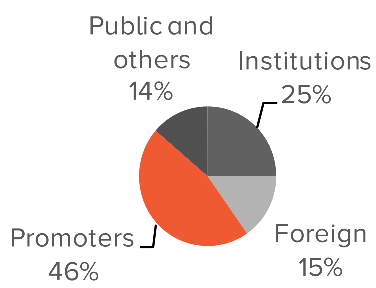
Ipca Laboratories

Reco: Buy | CMP: Rs954

Company details

Price target:	Rs1,135
Market cap:	Rs12,039 cr
52-week high/low:	Rs1,042/590
NSE volume: (No of shares)	2.0 lakh
BSE code:	524494
NSE code:	IPCALAB
Sharekhan code:	IPCALAB
Free float: (No of shares)	6.8 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	4.7	24.1	48.1	34.8
Relative to Sensex	2.4	14.3	26.0	18.3

Key points

- **Domestic formulations business on strong foothold:** Ipca Laboratories Limited (Ipca) is well placed to grow above industry in the domestic formulations market (46% of sales), led by strong growth in the pain, dermatology and urology therapies. The company delivered 17% y-o-y growth in this segment for the first nine months of FY19, compared to industry growth of 9.5-10% during the same period. We expect Ipca to perform well in the dermatology and urology segments as it has introduced new combinations and growth in these segments has a low base. On an overall basis, we expect the domestic formulation business to clock an 18-19% CAGR in sales during FY19-21E.

- **Exports business visibility improves:** The company's UK generics business was affected severely by the regulator's imposition against Ipca's major customer. The regulatory hurdle at distributor's end is now resolved and hence we expect this business to pick up gradually. Also, Ipca has been re-selected as the panel supplier for anti-malarial medicines to the global fund pooled procurement mechanism and for private sector co-payment mechanisms for an initial period of three years in FY19. Thus, the exports business is getting better visibility and we expect this to reflect in the numbers from FY2020E.

- **API business environment favourable:** The supply disruption due to environment led issues in China and regulatory issues for peers helped Ipca to gain momentum in API business, which we expect to sustain going forward as well. Currently, the overall API business contributes to ~25% of total sales. We expect the business to clock a CAGR of 16-18% by FY2021E on the back of better pricing environment and increased volume offtake.

- **Overall strong outlook for next 2-3 years:** Strong growth in the domestic formulations business, increased opportunities in the API space and additional business from the institutional anti-malaria segment indicates a strong earnings potential over next 2-3 years. Despite USFDA issues remaining unresolved, Ipca has managed to return to earnings level of that in FY2014 (pre-import alert from the USFDA), thereby indicating healthy performance in domestic business.

- **Remediation measures completed; await USFDA re-inspection:** The management has spent considerable amount of time towards remediation cost for the facilities under import alert. Ipca has submitted response to all queries of USFDA related to all its three sites, with no queries pending currently. Therefore, we expect the USFDA to re-inspect facilities anytime in the near term. A successful outcome of the inspection would be key to resolve regulatory issues. Thus, we have not factored in any meaningful business from the US as we await clarity on the inspection outcome.

- **Re-initiate buy with PT of Rs 1135:** Taking all of the above mentioned points into consideration, we feel most of the headwinds that impacted sales and profitability of the company (except for import alert from USFDA) are behind. Thus we expect Ipca to report sales/profit CAGR of 20%/28% over FY2019-FY2021E. Hence we re-initiate buy with TP of Rs 1135 (valuing 20xFY2021E earnings). Resolution of the USFDA issues could provide further upside.

- **Key Risks:** Lack/delay of clearances by other drug regulators would affect the export business outlook; Addition of drugs in the National List of Essential Medicines (NLEM) could hurt the domestic business; weakness in emerging market currencies could affect growth prospects.

Valuation Rs cr

Particulars	FY2018	FY2019E	FY2020E	FY2021E
Net sales	3,283.6	3,857.5	4,612.0	5,516.6
PAT	239.4	440.0	568.1	717.4
Shares in issue (cr)	12.6	12.6	12.6	12.6
EPS (Rs)	19.0	34.9	45.0	56.9
PER (x)	50.4	27.4	21.2	16.8
EV/Ebidta (x)	27.8	18.5	13.7	10.8
Book value (Rs/share)	213.0	247.9	292.9	349.8
P/BV (x)	4.5	3.9	3.3	2.7
Mcap/sales	3.8	3.2	2.7	2.2
RoCE (%)	9.1	14.3	18.4	21.3
RoNW (%)	9.5	14.1	16.8	17.8

Q4FY2019 result expectation: We expect Ipca to report strong Q4FY2019 numbers. We expect sales to grow by 11% to Rs. 865 crore led by strong performance in the domestic business and a sequential improvement in the US business. Operating profit is likely to grow by more than 40% to Rs. 168 crore. Margin expansion will be supported by a better product mix and the low base of Q4FY2018. Profit growth will exceed 75%, and probably come in at Rs. 105 crore due to low base in corresponding quarter of Q4FY2018, which was affected by weak US sales.

Company background: Ipca is a fully-integrated Indian pharmaceutical company, manufacturing more than 350 formulations and 80 APIs for various therapeutic segments. Ipca is a therapy leader in India for anti-malarials with a market-share of over 34% with a fast-growing presence in the international market as well. It has leading brands in five therapeutic areas, with 3 of its branded formulations being ranked among the top-300 Indian brands by ORG-IMS. Ipca's APIs and formulations are produced at manufacturing facilities approved by leading drug regulatory authorities including the US-Food and Drug Administration (US FDA), UK-Medicines and Healthcare products Regulatory Agency (MHRA), South Africa-Medicines Control Council (MCC), Brazil-Brazilian National Health Vigilance Agency (ANVISA) and Australia-Therapeutic Goods Administration (TGA) with operations in more than 100 countries.

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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