Sharekhan
by BNP PARIBAS

Ipca Laboratories

On a strong footing

Sector: Pharmaceuticals
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 1,420**	
Price Target: **Rs. 1,590**	↑

↑ Upgrade ↔ No change ↓ Downgrade

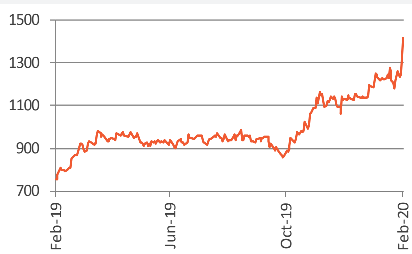
Company details

Market cap:	Rs. 17,942 cr
52-week high/low:	Rs. 1,441/743
NSE volume: (No of shares)	1.97 lakh
BSE code:	524494
NSE code:	IPCALAB
Sharekhan code:	IPCALAB
Free float: (No of shares)	6.8 cr

Shareholding (%)

Promoters	46.1
FII	14.7
DII	25.9
Others	13.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	11.2	20.8	37.4	79.2
Relative to Sensex	11.2	17.3	24.0	54.2

Sharekhan Research, Bloomberg

Ipca Laboratories Limited (Ipca) reported impressive results for Q3FY2020 that were ahead of estimates. Aided by a strong double-digit growth across the formulations and API businesses, topline rose by 20.5% y-o-y to Rs 1212.9 crore. Operating profit stood at Rs 273.7 crore, up by 16.7% y-o-y and was ahead of estimates. Lower tax rate coupled with strong operating performance led to adjusted PAT rising 25.5% y-o-y to Rs 200 crore. Expected traction across the formulation and API businesses and a substantial drop in remedial cost are expected to be key earnings drivers. We expect Ipca's sales and profits to grow at a CAGR of 16% and 20%, respectively, during FY2020-FY2022. Further, a successful inspection outcome from the USFDA would be a key trigger for earnings upgrades.

Key positives

- Sturdy revenue growth of 20.5% y-o-y for the quarter, on account of a double digit growth across verticals.
- Operating profit and adjusted PAT grew impressively by 16.7% and 25.5% y-o-y, respectively for Q3FY2020.
- Remediation costs for Q3FY2020 stood at Rs 2.5 crore, down from Rs. 4 crore as of Q2FY2020. The management expects remedial cost to drop going ahead substantially.

Key negatives

- Raw material cost / sales increased 130 bps y-o-y.

Our Call

Valuation – Maintain Buy with revised PT of Rs. 1,590: Ipca is on a strong footing and is well-placed to capitalise on growth opportunities across domestic as well as exports markets, in both the formulations and API segments. Performance of both segments is expected to improve as most headwinds have receded. The management expects strong growth momentum to continue going ahead. Given the robust performance in Q3FY2020, we have revised our earnings estimates upward for FY2020 / FY2021 and have also introduced FY2022 estimates in this note. We expect Ipca to report a sales/profit CAGR of 16% and 20% over FY2020-FY2022, respectively. At CMP, the stock is trading at an attractive P/E multiple of 18.9x its FY2022 earnings. We maintain our Buy recommendation on the stock with a revised PT of Rs. 1,590. Successful resolution of USFDA regulatory issues could provide a further upside with potential for upgrade of earnings estimates.

Key Risks

1) Lack/delay of clearance by other drug regulators would impact the export business outlook; 2) Addition of drugs in NLEM list could hurt the domestic business; and 3) Weakness in emerging market currencies could affect the growth prospects.

Valuation (Consolidated) Rs cr

Particulars	FY2019	FY2020E	FY2021E	FY2022E
Net sales	3,773.2	4,600.3	5,307.3	6,223.0
OPM (%)	18.3	21.0	21.4	21.5
PAT	442.2	658.2	799.9	949.9
EPS (Rs)	35.1	52.2	63.4	75.3
PER (x)	40.5	27.2	22.4	18.9
EV/Ebidta (x)	26.3	18.5	15.3	12.6
RoCE (%)	15.4	20.3	20.8	21.0
RoNW (%)	15.3	19.1	19.2	18.8

Source: Company; Sharekhan estimates

Strong results PAT beat estimates: Q3FY2020 results were strong and ahead of estimates. The topline at Rs 1212.9 crore grew 20.5% y-o-y. Both the formulations and API segments grew in strong double digits, by 19% and 24% y-o-y, respectively. Operating profit stood at Rs 273.7 crore, up by 16.7% y-o-y. Operating margins at 22.6% y-o-y, declined by 70 bps y-o-y, but were ahead of our estimates. The fall in OPM can be attributed to a dip in gross margins. Ipca's tax rate for the quarter was lower at 15.6% as against 19% in corresponding quarter of the last year. This coupled with a strong operating performance, led to adjusted PAT rising by 25.5% y-o-y to Rs 200 crore and comfortably beating the estimates of Rs 168 crore.

Strong outlook for 2-3 years: Ipca's two business segments – formulations and APIs are well-placed to seize opportunities going ahead. The formulations segment's revenues increased by 19% y-o-y for Q3FY2020, while the API segment revenues grew by a sturdy 24%. The management is confident of sustaining the growth momentum going ahead. A strong growth in the domestic formulations business and increased opportunities in the API space and additional business from the institutional segment indicates a strong growth potential in the next 2-3 years. In the formulations business, the management expects to comfortably outpace market growth, backed by a strong, double-digit growth in its top 10 brands. The other brands too are expected to grow by around 10%. In the API space, alternative sourcing opportunities (as most companies look to India as an alternative sourcing destination to China) is expected to be a key growth driver. A double-digit topline growth and reduction in remedial cost, from FY2021 augurs well for the company and would drive up OPM. Given the sturdy growth momentum, the management has guided for a 15-16% y-o-y topline growth in Q4FY2020. On an overall basis, we expect sales and profit to clock a CAGR of 16% and 20%, respectively over the next two years.

Q3FY2020 Conference Call Highlights

- Top 10 brands constituting around 55% of the revenues have clocked a 19% y-o-y growth for Q3FY2020. The management expects the strong growth momentum to sustain going ahead and has guided for a 15-16% y-o-y growth in Q4FY2020.
- Ipca has submitted response to all queries of USFDA-related to all its three sites, with no queries pending currently. A reply from the regulator is awaited. Successful outcome of USFDA inspection would be positive for the company.
- Remedial cost incurred for Q3FY20 stood at Rs 2.5 crore, and for 9MFY2020 the number was Rs. 13 crore. The management has guided for a remedial cost of Rs. 15-16 crore for FY2020. Going ahead the remedial cost is expected to significantly fall over the next two years.
- For FY2021, the management has guided for a capex of Rs. 250-300 crore capex. Of this, a major chunk is towards the API segment.
- Ipca sources a few Key Starting Materials from China. The management expects the supplies from China to start by mid of March 2020. Given that the company has ample stocks that would suffice till April 2020 and hence any disruption due to Coronavirus is unlikely.

Results (Consolidated) Rs cr

Particulars	Q3FY2020	Q3FY2019	y-o-y %	Q2FY2020	q-o-q %
Net sales	1212.9	1006.1	20.5	1283.9	-5.5
Operating profit	273.7	234.5	16.7	265.9	2.9
Other income	18.13	13.3	35.9	14.8	22.5
EBIDTA	291.8	247.8	17.7	280.7	4.0
Interest	4.01	5.1	-21.7	4.2	-5.2
Depreciation	50.83	45.7	11.1	49.6	2.4
Adjusted PAT	200.1	159.5	25.4	194.9	2.6
Margins			**bps**		**bps**
OPM (%)	22.6	23.3	-74.0	20.7	185.5

Source: Sharekhan Research

Geographical Sales Break-Up – Quarterly — Rs cr

Formulation	Q3FY2020	Q3FY2019	y-o-y %	Q2FY2020	q-o-q%
Domestic	485.63	421.57	15.2	543.2	-10.6
Exports	**353.4**	**282.4**	**25.2**	**340.8**	**3.7**
Branded Generics	112.98	104.58	8.0	100.2	12.8
Institutional	47.82	38.85	23.1	61.5	-22.2
Generics	192.63	138.96	38.6	179.2	7.5
Total Formulation	**839.1**	**704.0**	**19.2**	**884.0**	**-5.1**
APIs					
Domestic	53.18	44.5	19.5	67.2	-20.8
Exports	232.18	185.56	25.1	247.2	-6.1
Total APIs	**285.4**	**230.1**	**24.0**	**314.4**	**-9.2**
Subsidiaries	73.79	58.55	26.0	71.3	3.4
OOI	14.65	13.57	8.0	14.2	3.5
Total Sales	**1212.9**	**1006.1**	**20.5**	**1283.9**	**-5.5**

Source: Company, Sharekhan Research, Industry Reports

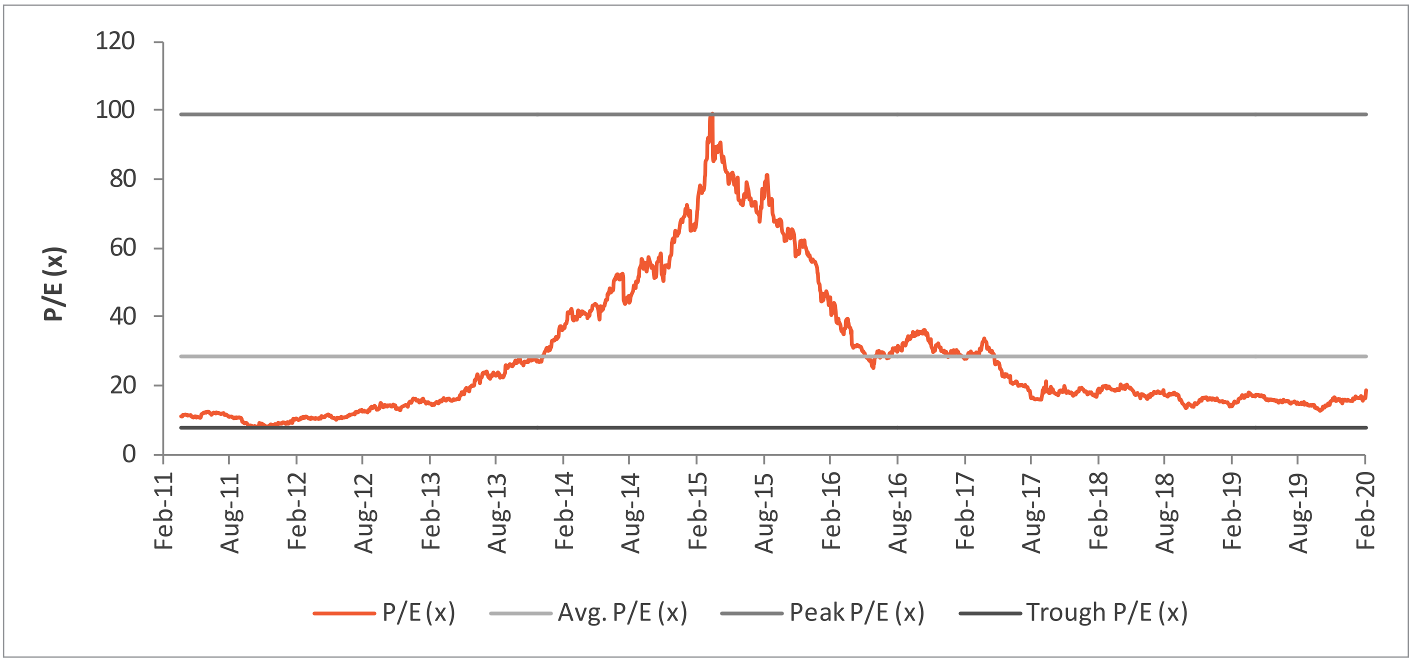
Outlook

Strong growth in the domestic formulation business and increased opportunities in the API space and additional business from institutional segment indicates strong earnings potential for the company in the next 2-3 years. The management is also evaluating new therapeutic areas that would boost the overall growth for the company. The sales and PAT are expected to clock a 16% and 20% CAGR, respectively, over the next two years.

Valuation

Maintain Buy with revised PT of Rs. 1,590: Ipca is on a strong footing and is well-placed to capitalise on growth opportunities across domestic as well as exports markets, in both the formulations and API segments. Performance of both segments is expected to improve as most headwinds have receded. The management expects strong growth momentum to continue going ahead. Given the robust performance in Q3FY2020, we have revised our earnings estimates upward for FY2020 / FY2021 and have also introduced FY2022 estimates in this note. We expect Ipca to report a sales/profit CAGR of 16% and 20% over FY2020-FY2022, respectively. At CMP, the stock is trading at an attractive P/E multiple of 18.9x its FY2022 earnings. We maintain our Buy recommendation on the stock with a revised PT of Rs. 1,590. Successful resolution of USFDA regulatory issues could provide a further upside with potential for upgrade of earnings estimates.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

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-malarias with a market share of over 34% with a fast-growing presence in the international market as well. The company has leading brands in five therapeutic areas, with three 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 USFDA, U.K.-Medicines and Healthcare 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.

Investment theme

Strong growth in the domestic formulation business coupled with increased opportunities in the API space and additional business from institutional segment indicates strong earnings potential over the next 2-3 years. We feel most headwinds that impacted sales and profitability of the company (except for import alert from USFDA) are behind. The Management is also evaluating new therapeutic areas, that would boost the overall growth for the company.

Key Risks

1) Lack/delay of clearance by other drug regulators would impact the export business outlook; 2) Addition of drugs in NLEM list could hurt the domestic business; and 3) Weakness in the emerging market currencies could affect growth prospects.

Additional Data

Key management personnel

Premchand Godha	Chairman and Managing Director
Ajit Kumar Jain	Joint Managing Director
Dr. Ashok Kumar	President - R&D (Chemical)
E. J. Babu	President - API
Dr. Goutam Muhuri	President - R&D (Formulations)
Kavita Sehwani	President - Generics
Sunil Ghai	President – Marketing
Harish Kamath	Corporate Counsel & Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	DSP Investment Managers Pvt Ltd	6.05
2	Chandurkar Investments Pvt Ltd	5.52
3	Paschim Chemicals Pvt Ltd	3.98
4	HDFC Asset Management Co Ltd	3.65
5	Lavender Investments Ltd	2.88
6	Norges Bank	2.06
7	UTI Asset Management Co Ltd	2.04
8	ICICI Prudential Asset Management	1.78
9	L&T Mutual Fund Trustee Ltd/India	1.56
10	Mirae Asset Global Investments Co	1.49

Source: Bloomberg

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