Sharekhan by BNP PARIBAS

Ipca Laboratories Limited

Stellar quarter; Promising outlook

Stock Update

Sector: Pharmaceuticals
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 2,008**	
Price Target: **Rs. 2,365**	↑

↑ Upgrade ↔ No change ↓ Downgrade

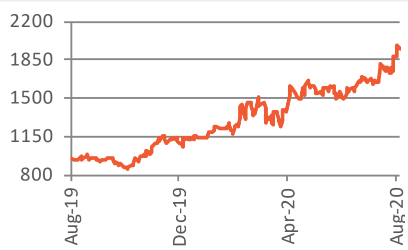
Company details

Market cap:	Rs. 25,371 cr
52-week high/low:	Rs. 2,175 / 844
NSE volume: (No of shares)	5.04 lakh
BSE code:	524494
NSE code:	IPCALAB
Sharekhan code:	IPCALAB
Free float: (No of shares)	6.8 cr

Shareholding (%)

Promoters	46.1
FII	13.2
DII	28.1
Others	12.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	20.8	28.9	60.9	108.5
Relative to Sensex	15.8	7.2	67.7	106.3

Sharekhan Research, Bloomberg

Ipca Laboratories Limited (IPCA) reported a stellar performance for the quarter backed by impressive growth in the API segment. The revenues at Rs 1534 crore grew by 42.3% y-o-y on the back of sturdy 72% y-o-y growth in the API segment, while the formulations business was up by 36.6% y-o-y. The operating profit was up 195% y-o-y to Rs 587 crore. The operating margins surprised positively expanding by 1983 BPS y-o-y to 38.3%, attributable to favorable mix, low costs and expansion in gross margins. Strong operating performance percolated to the bottom line as well. Therefore the PAT at Rs 445 cr was up 243% y-o-y and was ahead of estimates. IPCA has guided for a double-digit revenue growth for FY2021 on the back of healthy growth across both the API and formulations segments. In the API segment, immense growth opportunity lies ahead. The company is witnessing strong demand traction in the API segment and is implementing de-bottlenecking to ease out the capacity constraints. This will fuel growth over the next two years. By FY2023, the Dewas expansion is likely to come on stream and drive the topline. The formulations business to is expected to grow at a healthy pace. IPCA sees margin expansion in FY2021, to be driven by favorable mix, operating leverage and lower costs. Collectively, strong revenue growth coupled with margin expansion and almost a close to nil remedial costs augurs well for Ipca. We expect sales and PAT to grow by 18% and 41% CAGR respectively over FY2020-FY2022. Strong earnings visibility amidst uncertain times augurs well for the company. IPCA's two manufacturing plants at Pithampur and Pipariya are under USFDA scrutiny. The company has submitted its responses and is awaiting a reply. Successful inspection outcome from the USFDA is critical and would be a key trigger for earnings upgrades.

Key positives

- Sturdy revenue growth of 42.3% y-o-y backed by a 72% y-o-y growth in API's and a 36.6% growth in formulations.
- Gross margins expanded 950 bps y-o-y leading to 1983 bps expansion in OPM's to 38.3%.
- The Management has marginally raised its FY2021 revenue growth guidance to 18-19% from 14-17% earlier.

Key negatives

- Other Income declined by 40% y-o-y to Rs 12 cr.
- The management expects the sales momentum from HCQS to normalize as USFDA has withdrawn its emergency use authorization.

Our Call

Valuation – Maintain Buy with revised PT of Rs. 2365: IPCA is a leader in the anti-malarial space and has presence in other therapy areas as well. Q1FY2021 was a phenomenal quarter for the company as both its segments – API and formulations have clocked sturdy double-digit growth. The management sees the double digit growth trajectory to sustain for FY2021 and has marginally revised its growth guidance upwards to 18-19% as compared to 14-17% earlier. Operating leverage and likely lower cost benefits, favorable mix could result in margin expansion. IPCA is implementing de-bottlenecking exercise at its existing plants in the API segment, to ease out capacity constraints. Over the long term, the commissioning of new facilities at Dewas would aid revenue growth. Given the strong performance in Q1FY2021, we have revised our estimates upwards for FY2021 / FY2022. IPCA's sales and PAT are expected to clock a CAGR of 18% and 41% respectively over FY2020-FY2022. At CMP, the stock is trading at valuation of 26.6x/21.2x its FY2021 / FY2022 EPS. Strong earnings prospects amidst uncertain times, a sturdy balance sheet and healthy return ratios augur well for IPCA. We retain our Buy recommendation on the stock with revised PT of Rs 2365. IPCA has completed all the remediation process at its Pipariya and Pithampur plants and is now working with the USFDA for a resolution. The clearance of both these plants is critical from a growth perspective.

Key Risks

1) Delay in regulatory clearance of Pithampur and Pipariya plants 2) adverse changes in the regulatory landscape could have an adverse impact on the profitability.

Valuation (Consolidated) Rs cr

Particulars	FY2018	FY2019	FY2020	FY2021E	FY2022E
Net sales	3,283.6	3,773.2	4,648.7	5,473.1	6,451.9
OPM (%)	13.8	18.3	19.5	24.2	25.2
PAT	239.4	442.2	603.6	953.7	1,192.4
EPS (Rs)	19.0	35.1	47.8	75.6	94.5
PER (x)	105.8	57.3	42.0	26.6	21.2
EV/Ebidta (x)	57.0	37.1	28.4	19.1	15.0
RoCE (%)	9.1	15.4	18.6	24.6	25.3
RoNW (%)	9.5	15.3	18.1	23.4	23.2

Source: Company; Sharekhan estimates

Stellar performance; Q1FY21 results ahead of estimates: IPCA reported stellar performance for the quarter backed by an impressive growth in the API segment. The revenues at Rs 1534 crore grew by 42.3% y-o-y backed by a sturdy 72% y-o-y growth in the API segment, while the formulations business was also up by 36.6% y-o-y . The quarter also reflected incremental sales from Covid related medicines – Hydrooxychloroquine (HCQS) and Chloroquine (CHQ). Together both these medicines accounted for around Rs 260 crore of revenues. The operating profit was up 195% y-o-y to Rs 587 crore. The operating margins surprised positively expanding by 1983 BPS y-o-y to 38.3 crores. This is way above the estimates. The gross margins for the quarter also expanded by a strong 950 bps y-o-y . Operating margins were largely driven by higher sales of COVID-19 related products – HCQS and CHQ, which commanded disproportionately higher margins. In addition to this, IPCA was successfully able to pass on the higher input prices, and also reaped the benefits of low operating expense as offices and marketing staff operated at abnormally low levels during the lockdown period. The strong operating performance has percolated to the bottom line as well. Therefore the PAT for the quarter at Rs 445 cr was up multifold by 243% y-o-y and is ahead of estimates.

Management revises FY21 topline guidance by a tad upwards to 18-19%; API's to grow in double digits: IPCA is a largely formulations player with a presence in the API segment as well. It is a leader in anti-malaria space. For Q1FY2021, both the API as well as formulations segment have performed phenomenally well. Sales grew 72% y-o-ywhile that of formulations was up 36.6% y-o-y respectively. The company has benefitted from opportunities from COVID-19 related medicines, which are expected to normalise gradually. IPCA has indicated strong double digit growth going ahead. In the API segment, IPCA's growth could be constrained by capacities, though de-bottlenecking the existing capacities, would fuel the growth. Also IPCA is expanding the API facility a Dewas, which is expected to commence operations by FY2023. In the API segment, IPCA is focusing on products where its sees a potential for a shift to formulations, which would enable it to grow up the value chain. Further likely traction in the institutional business (Tender business) would drive the revenue growth. IPCA has guided for revenues of Rs 200 crore in FY2021 from the institutional business (Rs 176 cr in FY2020). The domestic formulations business is yet to see a full-fledged recovery. With a gradual relaxation of the lock down, doctors have commenced OPD consultations. This has resulted in a rise in the prescriptions, though a meaningful revival is awaited. IPCA expects a pick up within the next 1-2 quarters. In addition to the traction in the API and the formulation segments, favorable currency movement could also aid the topline growth. IPCA has marginally raised its topline growth guidance for FY2021 to 18-19% from the earlier levels of 14-17%.

New Dewas facility construction to begin in October; plant to be ready in the next 15 months: Ipca is expanding its API facilities at Dewas as it looks to reduce dependence on others for API and intermediaries. As of now, around 55% of its formulations business is backed by captive APIs, while a substantial portion of intermediates are imported from China. The development of Dewas plant would require capex of around Rs. 300 crore, of which the company plans to spend around Rs.50-60crore in FY2021. Ipca has received environmental clearance of the facility and plans to commence construction October 2020. The management expects the plant to be ready within the next 15 months. Also the recently acquired Nobel Expochem plant would be developed as a KSM plant over the long term. Collectively, the commissioning of Dewas plant and the Nobel facility would fuel the growth, though over the long term.

Q1FY2020 Conference Call Highlights

- The revenues for Q1FY2021 includes incremental sales from COVID-19 related medicines aggregating to Rs 259 cr. As IPCA's products – HCQS and CHQ's have been withdrawn for treatment of covid and hence the momentum is expected to normalize.
- IPCA is a leader in anti-malaria segment. The institutional business which comprises the tenders in the LMIC countries is expected to grow to around Rs 200 cr in FY2021 from Rs 176 cr in FY2020.
- In the API space- The three therapy areas of cardiovascular, anti-malaria and pain management constitute for a large share of API revenues ~75%.

- IPCA is evaluating to participate in the PLI (Performance Linked Incentive) scheme for bulk drug manufacturing, launched by the Government of India and evaluating to add new fermentation plants. Though the management has mentioned that the participation could be driven need to ease capacity constraints, and not due to the incentives offered.
- IPCA has guided for the raw material cost (as a % of sales) to be in the range of 31.5-32% for FY2021. This compares with a 32.5% level as of FY2020. Also other operating costs pressures are expected to be on the lower side for FY2021.
- IPCA's Pithampur and Pipariya facilities have been under the USFDA scrutiny. The company has completed the remediation process as well as the submission to the regulator. A reply from the regulator is awaited. Though in the light of Covid pandemic, IPCA expects a possible delay in the re-inspection of the plants. Consequently, the growth in the US business is likely to remain constrained. IPCA has filed for 2 DMF's and is awaiting a reply from USFDA.
- IPCA has received environmental clearance for its Dewas plant and expects to commence construction from October 2020. The investment for the said plant would be in the range of Rs 300 cr.

Results Rs cr

Particulars	Q1FY2021	Q1FY2020	YoY %	Q4FY2020	QoQ %
Net sales	1534.0	1078.2	42.3	1073.8	42.9
Expenditure	947.05	879.47	7.7	905.3	4.6
Operating profit	587.0	198.7	195.4	168.5	248.4
Other income	12.09	20.34	-40.6	13.73	-11.9
EBIDTA	599.0	219.1	173.5	182.2	228.8
Interest	2.74	4.59	-40.3	3.67	-25.3
Depreciation	51.03	46.1	10.7	63.94	-20.2
PBT	545.3	168.4	223.9	114.6	375.9
Tax	99.81	37.35	167.2	29.2	241.8
Net profit (reported)	444.8	129.6	243.2	86.0	417.2

Source: Company; Sharekhan Research

Geographical Sales Break-Up – Quarterly Rs cr

Particulars	Q1FY2021	Q1FY2020	YoY %	Q4FY2020	QoQ %
Domestic	489.41	452.81	8.1	430.96	13.6
Exports	**463.6**	**244.8**	**89.4**	**282.5**	**64.1**
Branded Generics	133.52	91.63	45.7	76.72	74.0
Institutional	88.67	27.32	224.6	39.71	123.3
Generics	241.45	125.87	91.8	166.04	45.4
Total Formulation	**953.1**	**697.6**	**36.6**	**713.4**	**33.6**
APIs					
Domestic	203.04	65.7	209.0	64.88	212.9
Exports	310.25	232.67	33.3	210.19	47.6
Total APIs	**513.3**	**298.4**	**72.0**	**275.1**	**86.6**
Subsidiaries	49.02	67.18	-27.0	68.97	-28.9
OOI	19.04	15.05	26.5	16.29	16.9
Total Sales	**1534.4**	**1078.2**	**42.3**	**1073.8**	**42.9**

Source: Company; Sharekhan Research

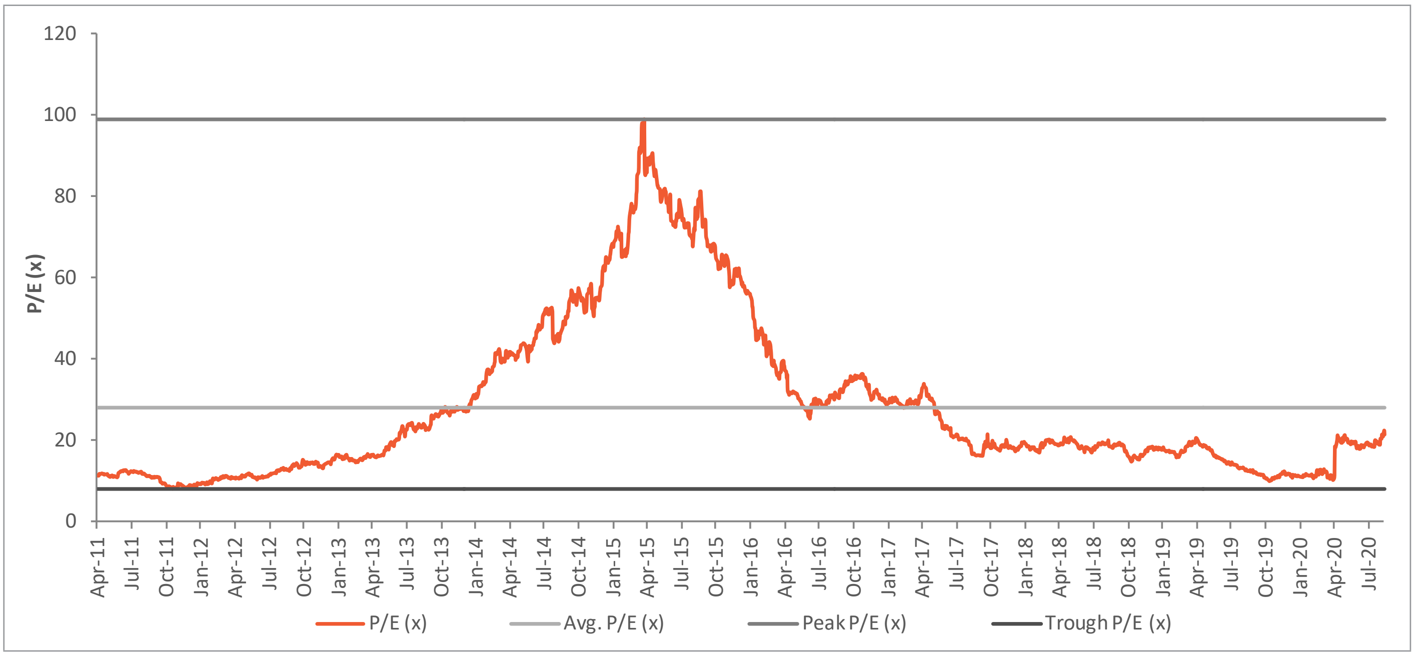
Outlook

IPCA is a fully integrated Indian pharmaceutical company, manufacturing more than 350 formulations and 80 APIs for various therapeutic segments. In the API segment, immense growth opportunity lies ahead. The company is witnessing strong demand traction in the API segment and is implementing de-bottlenecking to ease out the capacity constraints. This would fuel the growth over the next two years, and by FY2023 the Dewas expansion would come on stream and drive the topline. The formulations business to is expected to grow at a healthy pace. Given the strong performance in Q1FY21, IPCA has marginally revised its revenue guidance upwards by 18-19% and also expects to FY2021 OPM's to improve as compared to FY2020. The double-digit growth guidance provides comfort amidst uncertain times. Strong growth in the formulation business and increased opportunities in the API space and additional business from institutional segment indicates strong earnings potential for the company. The sales and PAT are expected to clock a 18% and 41% CAGR, respectively, over the next two years.

Valuation

Maintain Buy with revised PT of Rs. 2365: IPCA is a leader in the anti-malarial space and has presence in other therapy areas as well. Q1FY2021 was a phenomenal quarter for the company as both its segments – API and formulations have clocked a sturdy double digit growth. The management sees the double-digit growth trajectory to sustain for FY2021 and has marginally revised its growth guidance upwards to 18-19% as compared to a 14-17% guidance earlier. Operating leverage and overall lower cost pressures, favorable mix could result in margin expansion. IPCA is implementing de-bottlenecking exercise at its existing plants currently in the API segment to ease out capacity constraints. Over the long term, the commissioning of new facilities at Dewas would aid the revenue growth. Given the strong performance in Q1FY2021, we have revised our estimates upwards for FY2021 / FY2022. IPCA's sales and PAT are expected to clock a CAGR of 18% and 41% respectively over FY2020-FY2022. At CMP, the stock is trading at valuation of 26.6x/21.2x its FY2021 / FY2022 EPS. Strong earnings prospects amidst uncertain times, a sturdy balance sheet and healthy return ratios augur well for IPCA. We retain our Buy recommendation on the stock with revised PT of Rs 2365. IPCA has completed all the remediation process at its Pipariya and Pithampur plants and is now working with the USFDA for a resolution. The clearance of both these plants is critical from a growth perspective.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
IPCA Labs	2,008	12.6	25,372	42.0	26.6	21.2	28.4	19.1	15.0	18.1	23.4	23.2
Divis Laboratories	3,135	26.5	83,244	64.3	45.9	35.2	43.1	30.9	24.0	17.7	20.7	22.0

Source: Company, Sharekhan estimates

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 now behind it. The Management is also evaluating new therapeutic areas, that would boost the overall growth for the company. Also IPCA is implementing de-bottlenecking plans for its API facilities to ease the capacity constraints. Further it is setting up new API capacities at Dewas and is looking to build the Nobel expochem plant in to a KSM plant. Collectively incremental capacities coming on stream would fuel the growth, though over the long term.

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;

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	Chandurkar Investments Pvt Ltd	5.52
2	DSP Investment Managers Pvt Ltd	4.41
3	Paschim Chemicals Pvt Ltd	3.98
4	HDFC Asset Management Co Ltd	3.63
5	L&T Mutual Fund Trustee Ltd/India	3.26
6	Lavender Investments Ltd	2.88
7	UTI Asset Management Co Ltd	2.04
8	Axis asset Management Co Ltd	1.7
9	IDFC Mutual Fund	1.31
10	Canara Robeco Asset Management Company	1.14

Source: Bloomberg; data as on 17 June 2020.

Sharekhan

by BNP PARIBAS

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