

## Accumulate

### In line 2Q, accumulate on dips

IPCA's Q2FY21 numbers were in line with estimates. While the acute portfolio underperformed in 2Q in India (all-time lows on anti-malarial and anti-bacterial), management guided for a swift recovery in 2H (10% growth guided). Further, despite the cost structure picking up as field activities normalize, IPCA remains confident of sustaining EBITDA margins >25% in 2H. India business is driven by Cardiac and pain franchise (70% of sales). API business is driven by sartan supplies to emerging markets and there is a risk to prices if the global shortage resolves. Institutional tenders and a resumption in the US offer potential upside.

Company guided for capex of Rs2bn in FY21 and Rs3-3.5bn in FY22E. Revenues from incremental API capacity should kick-start from FY23 onwards. We believe strong API capabilities are at the core of IPCA's diversified exports business model, which, in our view, is a major competitive advantage, given growing cost pressures in global generics. Sustained outperformance in the branded domestic formulation space coupled with enhanced opportunities in the API segment indicates that IPCA has enough headroom to be on a strong earnings trajectory over the next 3-4 years.

Based on the growth outlook, we estimate significant strengthening of IPCA's balance sheet and expect the company to have ~Rs18bn net cash by FY22. This will provide IPCA with significant financial capacity to step-up growth investments if the opportunities arise. At CMP, the stock trades at 24x FY22 and 22x FY23 EPS. We recommend ACCUMULATE on dips.

**Q2FY21 Result Snapshot:** Top line grew a strong 6% YoY led by: i) API (21% YoY); and ii) tender business (33% YoY growth). India reported -1.4% YoY as acute segments especially anti-malarial underperformed. Nonetheless, with better product mix, gross margins came in at 67%. As opex increases sequentially, cost optimization measures led EBITDA margins at 25%.

### Q2FY21 Result (Rs Mn)

Particulars	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Revenue	13,611	12,839	6.0	15,344	(11.3)
Total Expense	10,180	10,157	0.2	9,521	6.9
EBITDA	3,431	2,682	27.9	5,823	(41.1)
Depreciation	521	496	5.0	510	2.1
EBIT	2,910	2,186	33.1	5,313	(45.2)
Other Income	155	148	4.4	121	27.8
Interest	23	42	(45.4)	27	(15.7)
EBT	3,212	2,268	41.6	5,466	(41.2)
Tax	526	319	64.9	999	(47.4)
RPAT	2,667	1,935	37.8	4,457	(40.2)
APAT	2,667	1,935	37.8	4,457	(40.2)
			(bps)		(bps)
Gross Margin (%)	67.5	65.0	250	71.9	(439)
EBITDA Margin (%)	25.2	20.9	432	38.0	(1274)
NPM (%)	19.6	15.1	452	29.0	(945)
Tax Rate (%)	16.4	14.1	231	18.3	(190)
EBIT Margin (%)	21.4	17.0	436	34.6	(1325)

CMP	Rs 2,262
Target / Upside	Rs 2,369 / 5%
NIFTY	12,461

### Scrip Details

Equity / FV	Rs 253mn / Rs 2
Market Cap	Rs 286bn
	USD 4bn
52-week High/Low	Rs 2,460/ 1,051
Avg. Volume (no)	379,578
Bloom Code	IPCA IN

### Price Performance

	1M	3M	12M
Absolute (%)	7	16	111
Rel to NIFTY (%)	7	15	117

### Shareholding Pattern

	Mar'20	Jun'20	Sep'20
Promoters	40.1	46.1	46.1
MF/Banks/FIs	30.6	31.0	31.8
FII	12.6	12.4	12.4
Public / Others	10.7	10.5	9.7

### Valuation (x)

	FY21E	FY22E	FY23E
P/E	26.2	24.0	22.0
EV/EBITDA	18.5	16.4	14.6
ROE (%)	26.7	23.5	21.1
RoACE (%)	23.8	21.6	19.8

### Estimates (Rs mn)

	FY21E	FY22E	FY23E
Revenue	55,004	62,762	70,976
EBITDA	15,018	16,386	17,797
PAT	10,912	11,913	13,011
EPS (Rs.)	86.4	94.3	103.0

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**Exhibit 1: Revenue Mix**

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	1HFY21	1HFY20	YoY (%)	FY21E	FY20	YoY (%)
Formulations	8,999	8,840	1.8	9,531	(5.6)	18,529	15,817	17.1	36,514	31,342	16.5
Domestic	5,355	5,432	(1.4)	4,894	9.4	10,249	9,960	2.9	21,421	19,126	12.0
Exports	3,644	3,408	6.9	4,636	(21.4)	8,280	5,857	41.4	15,093	12,216	23.6
Branded formulations	914	1,002	4,636.4	1,335	(31.6)	2,249	1,918	17.2	4,450	3,768	18.1
Generic formulations	1,911	1,792	6.6	2,415	(20.9)	4,325	3,050	41.8	8,245	6,684	23.3
Institutional business	819	615	33.3	887	(7.6)	1,706	888	92.1	2,398	1,763	36.0
API	3,810	3,144	21.2	5,133	(25.8)	8,943	6,127	46.0	14,703	11,731	25.3
Domestic	585	672	(12.9)	2,030	(71.2)	2,615	1,329	96.8	3,262	2,509	30.0
Exports	3,225	2,472	30.5	3,103	4.0	6,328	4,798	31.9	11,441	9,222	24.1
Subsidiaries	633	713	(11.2)	490	29.2	1,124	1,385	(18.9)	3,150	2,813	12.0
Total Sales	13,442	12,698	5.9	15,154	(11.3)	28,596	23,329	22.6	54,367	45,886	18.5

Source: Company, DART

### Conference call takeaways:

#### Guidance:

- India to grow 10% in 2H led by chronic segments as acute gets back on recovery mode.
- Traction in generic exports (UK/Europe) to continue. Branded exports guided at 10% growth for FY21E.
- Tender business guided to be better than earlier guidance of Rs2.4bn in FY21E.
- Management remains confident of healthy double digit growth in FY21E, led by improved output post de-bottlenecking exercise.
- EBITDA margin guided to sustain higher at 25-27% in 2H as management believes it still has scope of improvement w.r.t. plant utilization, process improvements and cost optimization at subsidiary levels.

**New API facility to come on stream from FY23E:** In a bid to de-risk from China and increase in-house manufacturing of intermediates, IPCA acquired an old facility, Noble Explochem through the NCLT approval for Rs690mn based out of Nagpur. The management plans to re-modify this plant into full-fledged intermediate facility as its current plants at Aurangabad and Mahad are running at optimum capacity. It would take ~18 months to revamp and commercialize the unit.

**Capex:** It has also bought a land parcel in Dewas in Q2FY20 to build a greenfield plant (received environmental clearance in Q1FY21), expected to be up and running by FY22E. Company guided for a capex of Rs2bn and Rs3-3.5bn for FY21E and FY22E respectively to be largely utilized for upgrading its API infrastructure, enhancing automation and setting up solar power plants. Dewas will add 300mt of API capacity, an addition of 20% to the current capacity.

**India:** Revenue from domestic formulations de-grew 1.4% YoY as anti-malarial sales were down 40% YoY. Ex anti-malaria, company saw growth in its portfolio led by pain (10% YoY) and cardiac segment (6% YoY). Chronic divisions in CNS, derma and ophthalmic have recovered QoQ. Pain and cardiac are now 70% of total sales. Differentiated products and clinical studies help IPCA build brand equity with prescribers.

**US:** IPCA continue to wait for clearance on its plants (Piparia and Indore SEZ) under import alert. We believe this will now happen beyond 2HFY22E. Currently these plants are running at ~20% capacity and IPCA continues to book losses to the tune of Rs600mn p.a. on them. IPCA has ~20 ANDAs filed from Indore and this remains a critical facility.

**Subsidiary – a proxy to the US:** In a bid to start its front end in the US, IPCA acquired 80% stake in Bayshore Pharma for US\$10mn last year. Bayshore reported sales of Rs750mn with minor loss due to goodwill 1H. Further, Bayshore can also be used to manufacture API if Indore SEZ does not get clearance soon.

IPCA also acquired Pisgah Labs in the US, in Jan 2018, which continues to remain loss making. It expects to turn profitable in FY22. The company is in the process of transferring technology to file 2 DMFs from Pisgah.

**Ex-US generic exports:** IPCA has smartly increased its business in Europe (ex-UK), which offers higher margins than overall company's blended margins. The issue with the distributor (receivables) has now been resolved. Going forward, company plans to start its own front end in Europe. This shall aid the generic segment from FY21E onwards as the European business ramps up. SA, Australia and Canada have supported the growth ably. Management guided for strong momentum in generics to continue.

**Tender business:** Institutional tender revenues grew 33% YoY as the order offtake from the global tender fund was high. The company expects the institutional tender business to generate revenues of >Rs2.4bn in FY21E (have injectable supply orders for the next 2 quarters). Further, IPCA has received approval for dispersible tablets of Arthemether Lumefantrine and expects to monetize this in FY22E.

**API:** 2Q was base without any HCQ supplies. IPCA reported 21% YoY growth (down 26% QoQ) in the API segment led by Losartan. Despite the higher base and lower price of sartans, management remains confident of 18-20% growth in 2HFY21E, led by improved output post de-bottlenecking exercise as its plants are running at full capacity. Further, given IPCA's lower dependency on China w.r.t intermediates and in-house manufacturing we expect IPCA to be relatively better placed vs. peers. Further, IPCA is planning to participate in the new PLI scheme introduced by the government for 2 of its products.

**Profit and Loss Account**

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
<b>Revenue</b>	<b>46,487</b>	<b>55,004</b>	<b>62,762</b>	<b>70,976</b>
<b>Total Expense</b>	<b>37,420</b>	<b>39,986</b>	<b>46,376</b>	<b>53,179</b>
COGS	16,441	18,142	20,731	23,405
Employees Cost	9,212	9,895	10,866	12,296
Other expenses	11,767	11,950	14,780	17,477
<b>EBIDTA</b>	<b>9,067</b>	<b>15,018</b>	<b>16,386</b>	<b>17,797</b>
Depreciation	2,105	2,012	2,139	2,235
<b>EBIT</b>	<b>6,962</b>	<b>13,005</b>	<b>14,246</b>	<b>15,562</b>
Interest	165	125	88	66
Other Income	670	678	627	637
Exc. / E.O. items	0	0	0	0
<b>EBT</b>	<b>7,467</b>	<b>13,558</b>	<b>14,786</b>	<b>16,134</b>
Tax	1,353	2,576	2,809	3,065
RPAT	6,036	10,912	11,913	13,011
Minority Interest	0	0	0	0
<b>Profit/Loss share of associates</b>	<b>(78)</b>	<b>(70)</b>	<b>(63)</b>	<b>(57)</b>
<b>APAT</b>	<b>6,036</b>	<b>10,912</b>	<b>11,913</b>	<b>13,011</b>

**Balance Sheet**

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
<b>Sources of Funds</b>				
Equity Capital	253	253	253	253
Minority Interest	256	256	256	256
Reserves & Surplus	35,903	45,299	55,696	67,191
<b>Net Worth</b>	<b>36,155</b>	<b>45,551</b>	<b>55,948</b>	<b>67,443</b>
Total Debt	4,139	3,289	2,439	1,939
Net Deferred Tax Liability	1,592	2,016	2,036	2,386
<b>Total Capital Employed</b>	<b>42,142</b>	<b>51,112</b>	<b>60,680</b>	<b>72,024</b>

**Applications of Funds**

Net Block	<b>20,444</b>	<b>20,420</b>	<b>20,280</b>	<b>19,546</b>
CWIP	1,477	1,604	1,751	1,920
Investments	618	773	966	1,207
<b>Current Assets, Loans &amp; Advances</b>	<b>30,040</b>	<b>38,844</b>	<b>48,222</b>	<b>61,401</b>
Inventories	13,231	13,677	14,219	15,840
Receivables	8,952	9,980	9,951	11,454
Cash and Bank Balances	1,809	8,422	16,532	25,721
Loans and Advances	2,323	2,792	3,321	3,948
Other Current Assets	1,342	1,590	1,816	2,056
<b>Less: Current Liabilities &amp; Provisions</b>	<b>10,436</b>	<b>10,529</b>	<b>10,540</b>	<b>12,051</b>
Payables	6,099	6,362	6,248	7,118
Other Current Liabilities	4,338	4,167	4,292	4,933
		<i>sub total</i>		
Net Current Assets	19,604	28,315	37,682	49,350
<b>Total Assets</b>	<b>42,142</b>	<b>51,112</b>	<b>60,680</b>	<b>72,024</b>

E – Estimates

**Important Ratios**

Particulars	FY20A	FY21E	FY22E	FY23E
<b>(A) Margins (%)</b>				
Gross Profit Margin	64.6	67.0	67.0	67.0
EBIDTA Margin	19.5	27.3	26.1	25.1
EBIT Margin	15.0	23.6	22.7	21.9
Tax rate	18.1	19.0	19.0	19.0
Net Profit Margin	13.0	19.8	19.0	18.3
<b>(B) As Percentage of Net Sales (%)</b>				
COGS	35.4	33.0	33.0	33.0
Employee	19.8	18.0	17.3	17.3
Other	25.3	21.7	23.5	24.6
<b>(C) Measure of Financial Status</b>				
Gross Debt / Equity	0.1	0.1	0.0	0.0
Interest Coverage	42.2	104.1	162.2	236.0
Inventory days	104	91	83	81
Debtors days	70	66	58	59
Average Cost of Debt	4.3	3.4	3.1	3.0
Payable days	48	42	36	37
Working Capital days	154	188	219	254
FA T/O	2.3	2.7	3.1	3.6
<b>(D) Measures of Investment</b>				
AEPS (Rs)	47.8	86.4	94.3	103.0
CEPS (Rs)	64.4	102.3	111.2	120.7
DPS (Rs)	1.2	9.6	6.0	6.0
Dividend Payout (%)	2.5	11.2	6.4	5.8
BVPS (Rs)	286.2	360.5	442.8	533.8
RoANW (%)	17.9	26.7	23.5	21.1
RoACE (%)	15.8	23.8	21.6	19.8
RoAIC (%)	18.6	31.3	32.8	34.4
<b>(E) Valuation Ratios</b>				
CMP (Rs)	2262	2262	2262	2262
P/E	47.4	26.2	24.0	22.0
Mcap (Rs Mn)	285,861	285,861	285,861	285,861
MCap/ Sales	6.1	5.2	4.6	4.0
EV	285,808	278,345	269,385	259,696
EV/Sales	6.1	5.1	4.3	3.7
EV/EBITDA	31.5	18.5	16.4	14.6
P/BV	7.9	6.3	5.1	4.2
Dividend Yield (%)	0.1	0.4	0.3	0.3
<b>(F) Growth Rate (%)</b>				
Revenue	23.2	18.3	14.1	13.1
EBITDA	31.0	65.6	9.1	8.6
EBIT	36.7	86.8	9.5	9.2
PBT	36.2	81.6	9.1	9.1
APAT	36.5	80.8	9.2	9.2
EPS	36.5	80.8	9.2	9.2

**Cash Flow**

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
CFO	3,855	12,183	13,313	13,670
CFI	(5,365)	(2,548)	(2,686)	(2,343)
CFF	497	(3,022)	(2,517)	(2,139)
FCFF	(1,510)	9,635	10,627	11,328
Opening Cash	2,823	1,809	8,422	16,532
Closing Cash	1,809	8,422	16,532	25,721

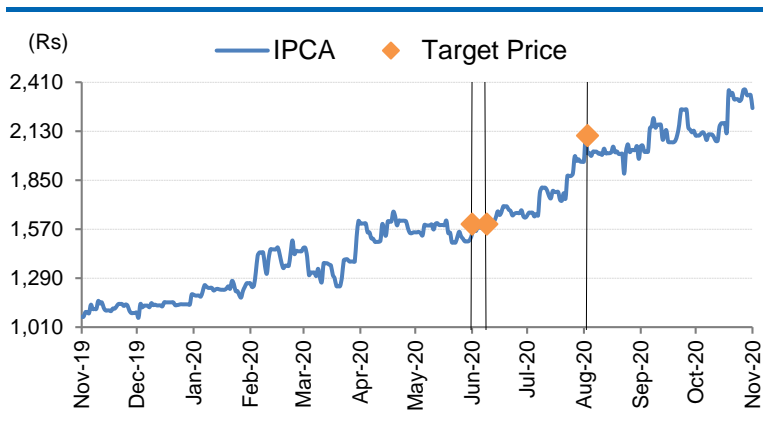
E – Estimates

### DART RATING MATRIX

Total Return Expectation (12 Months)

<b>Buy</b>	<b>&gt; 20%</b>
<b>Accumulate</b>	<b>10 to 20%</b>
<b>Reduce</b>	<b>0 to 10%</b>
<b>Sell</b>	<b>&lt; 0%</b>

### Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
Jun-20	Accumulate	1,600	1,543
Jun-20	Accumulate	1,600	1,563
Aug-20	Accumulate	2,106	2,006

\*Price as on recommendation date

### DART Team

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