Sharekhan by BNP PARIBAS

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Ipca Laboratories Limited

Growth prospects bright despite short-term blips

Pharmaceuticals	Sharekhan code: IPCALAB	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 2,071**	
Price Target: **Rs. 2,560**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 26,267 cr
52-week high/low:	Rs. 2,456 / 1,467
NSE volume: (No of shares)	5.04 lakh
BSE code:	524494
NSE code:	IPCALAB
Free float: (No of shares)	6.8 cr

Shareholding (%)

Promoters	46.3
FII	13.2
DII	28.1
Others	12.5

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-1.7	8.8	-5.7	38.6
Relative to Sensex	-8.2	3.1	-23.4	-21.6

Sharekhan Research, Bloomberg

Summary

- Ipca reported strong numbers for Q4FY21, though earnings missed estimates.
- The Formulations segment could be the key growth driver for IPCA labs, driven by a strong double digit growth of 15-18% in domestic formulations.
- Over the long term, strong demand and easing of capacity constraints with commissioning of the Dewas plant and additional capacities coming onstream at Ratlam in FY22 would drive the API segment's growth
- We maintain a Buy recommendation on the stock with an unchanged PT of Rs. 2,560.

Ipca Laboratories Limited (Ipca) reported strong numbers for Q4FY21, though earnings missed estimates. Sales stood at Rs. 1,114 crore, up 3.8% y-o-y on the back of an 8% growth in the formulations business, while the API segment sales declined 5.5%. OPM stood at 20.5%, rising by 484 bps y-o-y led by savings in the other expenses and a 350 bps y-o-y rise in gross margins. Therefore, operating profits stood at Rs. 228 crore, up 35.9% y-o-y. However, this was lower than estimates. Consequently, tracking strong operating performance and a lower depreciation and higher other income, PAT stood at Rs. 161.2 cr, up 94.1% y-o-y, but missed estimates. Going ahead, Ipca's formulations business is expected to be a growth driver led by a strong double-digit growth in the domestic formulations, while the exports are also likely to grow at a healthy pace given robust demand outlook. On account of a high base, in FY2021 due to COVID-led opportunities, domestic API segment sales are likely to tapper off in Fy2022, while the management expects the API exports to grow by ~10%. Over the long term, strong demand environment and easing of capacity constraints with the commissioning of the Dewas plant and additional capacities coming on stream at Ratlam in FY22 would drive the API segment growth. Overall, the management has guided for a 9-10% growth in topline for FY2022. On account of COVID-related one-off business, FY2021 margins are on the higher side; and with these benefits likely to taper off, the margin trajectory is expected to be around 25% levels going ahead, which is higher than the 18-19% levels seen in the past two years. Ipca's two manufacturing plants are under USFDA scrutiny and the company has submitted its responses and is awaiting a reply. Successful inspection outcome from USFDA is critical and would be a key trigger for earnings upgrades.

Key positives

- Revenues from the branded generics division and Institutional segment grew by 31.7% and 91.9% y-o-y, respectively.
- Gross margins expanded by 350 bps y-o-y due to a favourable mix.

Key negatives

- COVID-led challenges have delayed Dewas greenfield plant work.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 2,560: Ipca's domestic formulations which account for ~40% of the overall topline of the company is on a strong footing and the management has guided for a double digit growth of 15-18% in FY2022E. Consistent outperformance versus the Indian pharmaceutical market, strong position in the pain and gastro segments along with a healthy growth in cardiology segment are the key growth drivers for the segment. Growth prospects for the API segment are also strong, however due to a high base in FY2021 and capacity constraints, the API segment's growth could moderate for FY2022E and management has guided for mid single-digit growth. However, over the long term with the commissioning of Dewas plant and a robust demand outlook, would drive the API segment sales. Further, due to a one-time high margin business from HCQs (Rs. 365 crore) in FY2021, the margins for FY2022 are likely to normalize and the management expects margins to be at 25% for FY2022E. Overall, the management commentary suggests of near term hiccups for IPCA, but the long term growth levers are intact. Q4FY2021 was a strong quarter, though results missed estimates. Consequently we have revised downwards our earnings estimates for FY22E/FY23E by 8% and 3% respectively. At CMP, the stock is trading at valuation of 23.2x/20.3x its FY2022E/FY2023E EPS. Strong earnings prospects, a sturdy balance sheet, and healthy return ratios augur well for Ipca. As the company's long term growth levers are intact, we maintain a Buy recommendation on the stock with an unchanged PT of Rs. 2,560.

Key risk

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

Valuation (Consolidated) Rs cr

Particulars	FY2019	FY2020	FY2021	FY2022E	FY2023E
Net sales	3,773.2	4,648.7	5,420.0	5,950.3	6,558.0
Operating Profit	691.9	906.7	1,544.4	1,531.5	1,768.1
OPM (%)	18.3	19.5	28.5	25.7	27.0
PAT	442.2	603.6	1,141.1	1,126.1	1,288.6
EPS (Rs)	35.1	47.8	90.5	89.3	102.1
PER (x)	59.1	43.3	22.9	23.2	20.3
EV/Ebidta (x)	38.2	29.3	16.9	16.6	13.8
RoCE (%)	15.4	18.6	29.3	24.1	23.1
RoNW (%)	15.3	18.1	27.6	21.5	20.0
RoE (%)	16.5	22.4	21.0	21.4	23.6

Source: Company; Sharekhan estimates

Strong quarter, PAT Missed estimates: Q4 numbers were strong, though the earnings missed estimates. Sales stood at Rs 1,114 crore, up 3.8% y-o-y on the back of an 8% growth in the formulations business, while the API segment's sales declined. In the formulations segment, domestic sales were up by 1% y-o-y while in the exports segments the branded and institutional segment grew by 32% and 92% yoy respectively. The revenues were below the estimates. OPM stood at 20.5%, rising by 484 bps y-o-y led by savings in the other expenses and a 360 bps y-o-y rise in gross margins. The gross margins expansion is on the back of a favorable mix (low share of low margins acute therapy products) Therefore, operating profits for the quarter stood at Rs 228 cr, up by 35.9% y-o-y but were lower than estimates. Consequently, tracking the strong operating performance, coupled with a lower depreciation and higher other income the PAT for the quarter stood at Rs 161.2 crore, up 94.1% y-o-y, but missed estimates.

Formulations segment poised for a strong growth backed by a double-digit growth in domestic formulations: IPCA's overall formulations segment reported a growth of 8% yoy for the quarter to Rs. 771.6 crore. Growth in the formulations could be attributable to a 19.7% yoy growth in the exports due to a 31.7% y-o-y growth in the branded generics while the institutional segment sales were up by 91.9% yoy. The domestic formulations segment reported flat growth. Going ahead, the management expects the formulations segment to be a key driver of growth for the company in Fy2022, largely driven by a strong growth in the India formulations segment. In FY2021, the India formulations business had a one-time incremental business amounting to Rs 185 cr due to HCQS sales on account of COVID-led higher demand and despite this, IPCA has guided for 15-18% revenue growth from the domestic formulations business for FY22. In the Indian markets, the company has a strong presence in the pain / analgesics, Gastrointestinal segments followed by the cardiology. One of its strong brand Zerodol (pain management) has clocked an 18% growth in the FY2021 and is expected to sustain the strong growth trajectory. In domestic markets, a likely pick-up in therapies such as pain management, cardiac, neuro, and derma would drive growth, while anti-malarial, cough and cold segment would catch up gradually. In addition to this an improved growth of around high single digits to low double digits in IPM (Indian Pharmaceutical markets) for FY2022 would also have a positive rub off effect on the domestic formulations segments. On the exports front, IPCA expects the branded formulations segment to also stage a strong growth of 13-15% for Fy2022 while institutional segment and generic formulations segment is expected to stage a moderate growth of 5% each for FY2022. Overall we expect the domestic formulations business to clock a 16% CAGR over FY2021-FY2023E.

API Segment growth to moderate in FY22 led by a weakness in domestic markets; Exports API's to stage a healthy growth: The revenues from the API segment for the quarter stood at Rs 259.9 crore, translating in to a decline of 6% y-o-y. A large part of the decline is due to a 21.7% of the drop in the domestic API segment while the export API segment revenues were flat. Going ahead, the management expects the API segment growth to moderate in FY2022 to around mid single-digit growth. Revenues of the API segment include COVID-led HCQS API revenues amounting to Rs. 180 crore in FY2021, thus pointing at a high base. Also the current utilization rates of the AP segment are quiet on the higher side around 90%, this leaving little headroom to expand. Hence the management expects the revenues from the domestic API segment to decline in Fy22 as compared to FY21. On the other hand the export API segment sales are expected to grow by 9-10% for FY2022 led by a strong demand environment overall. Further the company is also de-bottlenecking its Ratlam plant which is expected to free up some capacities during FY2022. Collectively, on the back due to expected weakness in the domestic API segment, the overall API segment growth for FY2022 is expected to moderate, though over the long term the growth levers are intact and provide comfort on the growth visibility.

COVID-led disturbance to result in a delay for Dewas greenfield; Ratlam Plant likely to be ready in FY22: IPCA is expanding its API facilities at Dewas as it looks to reduce dependence on others for API and intermediaries. IPCA has internal APIs for around 62% of its formulations (this compares with 55% integration as of Q4FY2020). To reduce this dependence on external procurement, the company is setting up a new Greenfield plant at Dewas at an outlay of Rs. 300-350 crore. The company has commenced the civil work for the plant, but due to Covid led delays, the work has progressing at a slower than expected pace, leading to a delay in the completion. As per the earlier plans the Dewas plant was expected to be with the installations of machinery by Q4FY2022 and with the delay, the management expects the same to be ready in FY2023, post which it would take an year for the approvals and inspection to be done, before the commercial production commences. In addition to Dewas, Ipca is in the process of setting up a small API plant at its Ratlam facility with an installed capacity of 50 MT, which is likely to be ready soon and Ipca sees commercial operations from this to commence by in FY2022. The overall capex envisaged for the Ratlam plant is Rs. 100 crore.

Q4FY2021 Conference Call Highlights

- The institutional business, which comprises tenders in LMIC countries, has grown by sturdy 92% y-o-y for Q4. Ipca sees the trajectory to sustain ahead as well, backed by improved demand for global health agencies.
- Ipca's Pithampur and Pipariya facilities have been under the USFDA scrutiny. The company has completed the remediation process as well as a submission to the regulator. A reply from the regulator is awaited. Though in the light of the COVID-19 pandemic, Ipca expects a possible delay in the re-inspection of plants. Consequently, growth in the US business is likely to remain constrained.
- IPCA's is undertaking a de-bottlenecking exercise at its Ratlam plant (API's) and expects the same to be over by Q2FY22. While due to the Covid led challenges the work on the Dewas greenfield has been progressing slower than the schedule.
- **Guidance:** IPCA has guided for overall topline growth of ~10% for FY2022 driven by s strong growth in the formulations segment while the API segment sales growth is expected to moderate as compared to FY2021. The management has guided for the EBITDA margins of ~25% for Fy2022 as compared to 28.5% reported in FY2021. As FY2021 performance included one-time revenues of Rs 365 crore from the sale of HCQS (formulations as well as API) which commended exceptionally higher margins, guidance stands lower.

Results Rs cr

Particulars	Q4FY2021	Q4FY2020	YoY %	Q3FY2021	QoQ %
Net sales	1114.7	1073.8	3.8	1409.8	-20.9
Expenditure	885.75	905.3	-2.2	1042.9	-15.1
Operating profit	228.9	168.5	35.9	366.9	-37.6
Other income	19.92	13.73	45.1	15.38	29.5
EBIDTA	248.8	182.2	36.6	382.3	-34.9
Interest	1.7	3.67	-53.7	2.29	-25.8
Depreciation	52.5	63.94	-17.9	53.52	-1.9
PBT	194.6	114.6	69.9	326.5	-40.4
Tax	30.93	29.2	5.9	56.73	-45.5
Net profit (reported)	161.2	83.0	94.1	267.9	-39.8
			BPS		**BPS**
OPM (%)	20.5	15.7	484.8	26.0	-549.0

Source: Company; Sharekhan Research

Geographical Sales Break-Up – Quarterly Rs cr

Formulation	Q4FY2021	Q4FY2020	YoY %	Q3FY2021	QoQ %
Domestic	433.61	430.96	0.6	523.16	-17.1
Exports	**338.0**	**282.5**	**19.7**	**431.1**	**-21.6**
Branded Generics	101.01	76.72	31.7	77.5	30.3
Institutional	76.22	39.71	91.9	138.5	-45.0
Generics	160.77	166.04	-3.2	215.13	-25.3
Total Formulation	**771.6**	**713.4**	**8.2**	**954.3**	**-19.1**
APIs					
Domestic	50.79	64.88	-21.7	74	-31.4
Exports	209.15	210.19	-0.5	278	-24.8
Total APIs	**259.9**	**275.1**	**-5.5**	**352.0**	**-26.2**
Subsidiaries	73.74	68.97	6.9	94.61	-22.1
OOI	9.37	16.29	-42.5	15.38	-39.1
Total Sales	**1114.7**	**1073.8**	**3.8**	**1416.3**	**-21.3**

Source: Company, Sharekhan Research, Industry Reports

Outlook and Valuation

■ Sector View – Growth momentum to improve

Indian pharmaceutical companies are better placed to harness opportunities and report healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in the US generics market), rise in product approvals and plant resolutions by the USFDA, strong growth prospects in domestic markets, and emerging opportunities in the API space would be key growth drivers. This would be complemented by strong capabilities developed by Indian companies (leading to a shift towards complex molecules and biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharma companies.

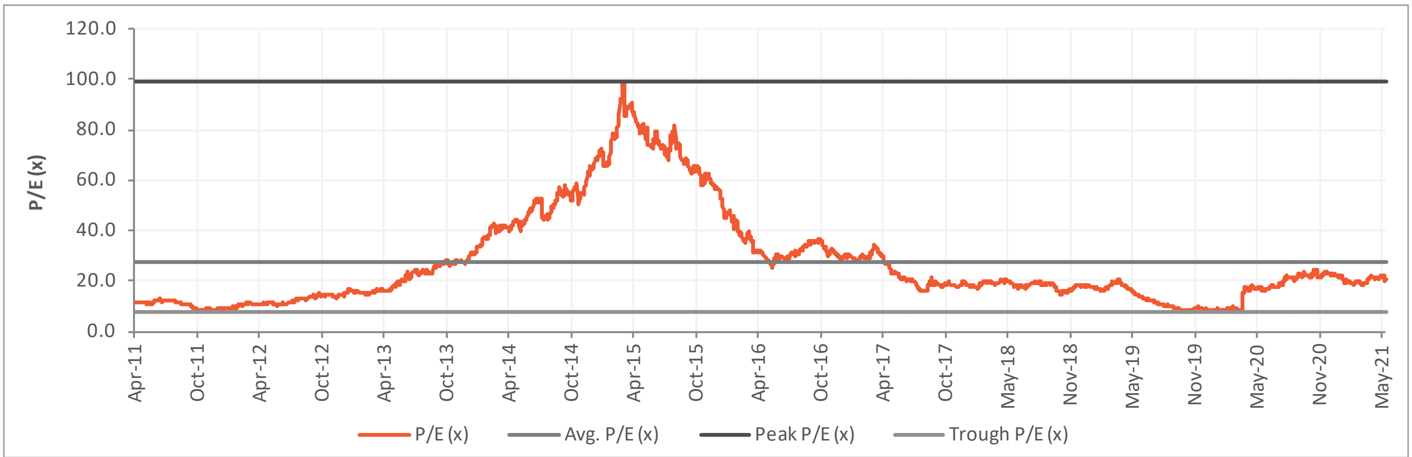
■ Company Outlook – Strong earnings growth

Ipca is a fully integrated Indian pharmaceutical company, manufacturing more than 350 formulations and 80 APIs for various therapeutic segments. The formulations business is expected to grow at a healthy pace and is likely to be a key growth driver for the company. In the formulations segment the domestic as well as exports segments are expected to grow at a healthy pace, though the domestic is likely to be growing higher than the exports segments. Also with ample capacity available for the formulations, augurs well for the company. 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 capacity constraints. This would fuel growth over the next two years, while over the long term Dewas expansion would come on stream and drive the topline. Moreover, the company is in the process of setting up a new API plant at Ratlam facility with a 50MT capacity, which is likely to commence operations in FY2022. The expected improvement in the formulation business and increased opportunities in the API space and additional business from the institutional segment indicate strong earnings potential for the company. In the near term due to capacity constraints and high base in the FY2021, the API segment sales growth is expected to moderate, though the long term growth levers are intact.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 2,560

Ipca's domestic formulations which account for ~40% of the overall topline of the company is on a strong footing and the management has guided for a double digit growth of 15-18% in FY2022E. Consistent outperformance versus the Indian pharmaceutical market, strong position in the pain and gastrointestinal segments along with a healthy growth in cardiology segment are the key growth drivers for the segment. Growth prospects for the API segment are also strong, however due to a high base in FY2021 and capacity constraints, the API segment's growth could moderate for FY2022E and management has guided for mid single-digit growth. However over the long term with the commissioning of Dewas plant and a robust growth outlook, would drive the API segment sales. Further due to a one time high margins business from HCQs (Rs. 365 crore) in FY2021, the margins for FY2022 are likely to normalize and the management expects margins to be at 25% for FY22. Overall, the management commentary suggests of near term hiccups for IPCA, but the long term growth levers are intact. Q4FY2021 was a strong quarter, though results missed estimates. Consequently we have revised downwards our earnings estimates for FY22E/FY23E by 8% and 3% respectively. At CMP, the stock is trading at valuation of 23.2x/20.3x its FY2022E/FY2023E EPS. Strong earnings prospects, a sturdy balance sheet, and healthy return ratios augur well for Ipca. As the company's long term growth levers are intact, we maintain a Buy recommendation on the stock with an unchanged PT of Rs. 2,560.

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/EBITDA (x)			RoE (%)		
				FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
IPCA Labs	2,071	12.6	26,267	22.9	23.2	20.3	16.9	16.6	13.8	27.6	21.5	20.0
Solara Active Pharma Sciences	1757	3.5	6313	28.2	23.8	18.2	17.0	13.5	10.7	13.9	14.4	16.2

Source: Company, 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, UK-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 the institutional segment indicate strong earnings potential over the next 2-3 years. We feel most headwinds that impacted the company's sales and profitability (except for import alert from USFDA) are now behind it. Management is also evaluating new therapeutic areas that would boost the company's overall growth. In addition, IPCA is implementing de-bottlenecking plans for its API facilities to ease capacity constraints. Further, IPCA 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 are coming on stream and would fuel 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
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; Note: Shareholding as of January 29, 2021

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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