Ipca Laboratories Limited

Promising Outlook

Pharmaceuticals	Sharekhan code: IPCALAB	Company 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. 1,865**	
Price Target: **Rs. 2,560**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

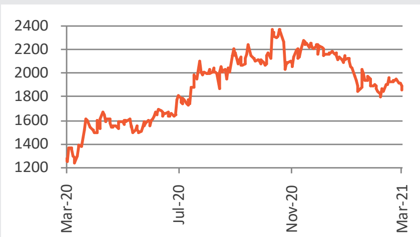
Company details

Market cap:	Rs. 23,655 cr
52-week high/low:	Rs. 2,456/1,166
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	0.0	-16.5	-14.2	45.5
Relative to Sensex	4.1	-21.3	-40.9	-25.0

Sharekhan Research, Bloomberg

Summary

- We maintain Buy recommendation on the stock of IPCA Laboratories Limited (Ipca) with an unchanged PT of Rs. 2,560.
- Ipca's domestic formulations that account for around 45% of the overall topline of the company is on a strong footing to report double digit growth over the next two years.
- Ipca's API business is also witnessing strong demand traction, which is expected to sustain going ahead
- Strong revenue growth supported by easing capacity constraints augurs well for Ipca from a growth perspective. Ipca's stock price has corrected by ~17%, thus providing a good entry point for investors.

IPCA Laboratories Limited's (IPCA) formulations segment revenues are set to grow strongly over the next two years, backed by a double digit growth in the domestic formulations. Over the past two months of January and February 2021, the company has consistently outperformed the IPM (Indian Pharmaceutical Markets) growth substantially attributable to the strong presence in the gastro – intestinal and pain segments. Further, healthy growth in the cardiology segment also supported the outperformance. Going ahead, with the IPM expected to grow in double digits (led by a pickup in volumes) in FY2022, is expected to have a positive rub off effect on Ipca's domestic formulations as well. The API segment has immense growth opportunities going ahead, as the company is witnessing strong demand traction in this segment and is de-bottlenecking existing capacities and setting up a small 50MT API plant at Ratlam (likely to go on stream by Q2FY22) to ease out capacity constraints. These would fuel growth in the near term and by FY2023, Dewas greenfield capacity expansion would come on stream and aid the topline growth. Collectively, strong revenue growth, supported by easing capacity constraints augurs well for Ipca. We expect sales and PAT to report a 15% and 30% CAGR, respectively, over FY2020-FY2023. Ipca has also applied under the PLI scheme for Sartans at Dewas plant and If approved this could be a positive development and could add to the earnings growth.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 2,560: Ipca's domestic formulations which account for around 45% of the overall topline of the company is on a strong footing to report double digit growth over the next two years. Consistent outperformance versus the IPM, strong position in the pain and gastro segments along with a healthy growth in cardiology segment are the key growth drivers for the segment. The API business is witnessing strong demand traction, which is expected to sustain going ahead. Ipca is facing capacity constraints in its API segment and to ease out the same, in the near term it is de-bottlenecking existing facilities as well as setting up 50 MT API plant at Ratlam. Over the long term, the Dewas expansion is expected to go on stream in FY2023 and would support growth. At CMP, the stock is trading at valuation of 19.2x/17.6x its FY2022E/FY2023E EPS. Strong earnings prospects, a sturdy balance sheet, and healthy return ratios augur well for Ipca. Further, over the span of past three months, Ipca has underperformed the Sensex as well as BSE Healthcare index by 21% and 11% respectively, and the stock price has also corrected by ~17%, thus providing a good entry point for investors. Hence we maintain Buy recommendation on the stock with an unchanged PT of Rs. 2,560.

Key Risks

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

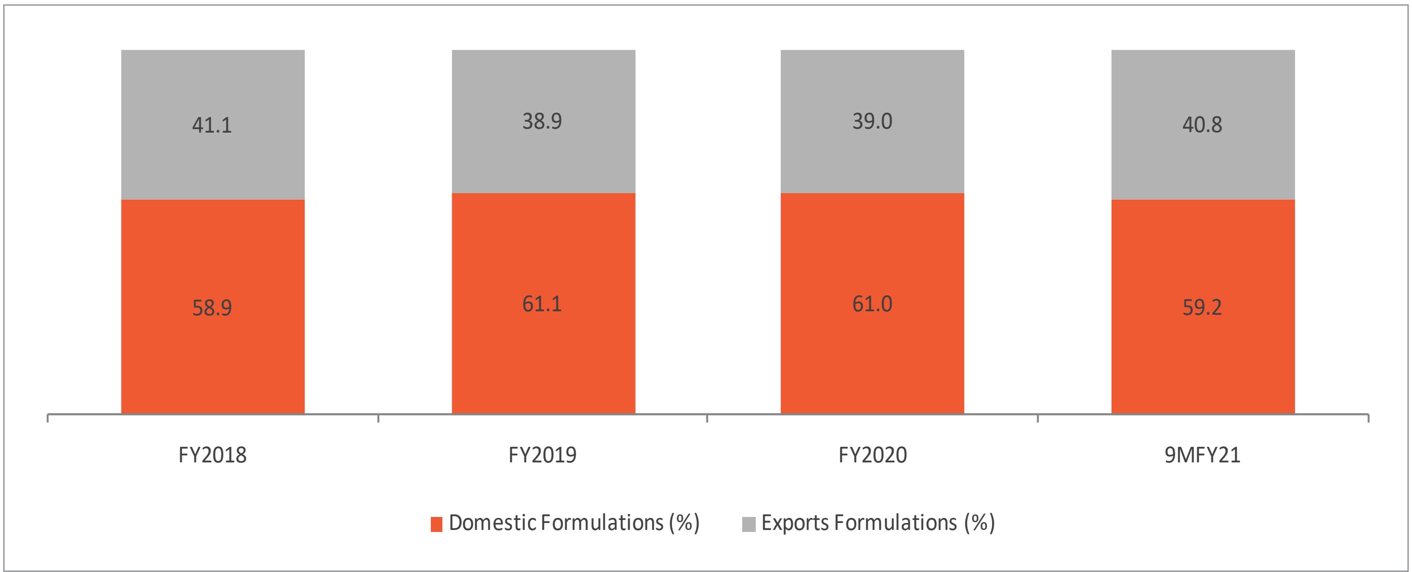
Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net sales	3,773.2	4,648.7	5,591.3	6,327.4	7,059.8
Operating Profit	691.9	906.7	1,604.2	1,700.0	1,855.1
OPM (%)	18.3	19.5	28.7	26.9	26.3
PAT	442.2	603.6	1,157.6	1,224.3	1,338.6
EPS (Rs)	35.1	47.8	91.8	97.1	106.1
PER (x)	53.2	39.0	20.3	19.2	17.6
EV/Ebidta (x)	34.4	26.4	14.6	13.1	11.5
RoCE (%)	15.4	18.6	29.8	25.6	23.0
RoNW (%)	15.3	18.1	27.7	22.8	20.2

Source: Company; Sharekhan estimates

Domestic formulations business on a strong footing to clock a double digit growth:

Ipca is largely a formulations player and derives around 73% of revenues (FY2020) from the formulations segment. The balance is constituted by the API segment. In the formulations segment Ipca caters to the domestic as well as exports markets, with the domestic business constituting around 60% of the total formulations sales. The balance, around 40% of the sales is derived from the exports markets. The revenue mix of the formulations segment is largely constant thus pointing at the leading position in the Indian markets. Given the higher share of the domestic sales, the fortunes of the formulations segment are linked to that of the growth of the IPM (Indian Pharmaceutical markets).

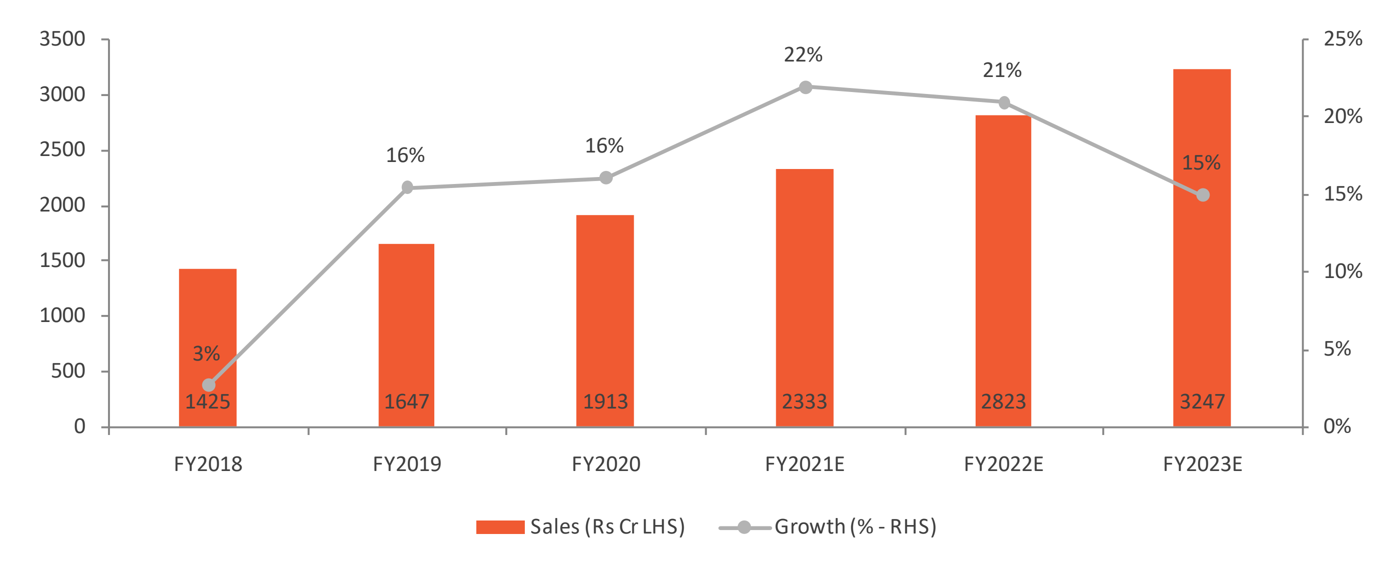
Formulations Segment - Sales Mix



Source: Company, Sharekhan Research

The IPM growth has been on an improving trajectory since October 2020, as the impact of the pandemic led lockdown has gradually begun to reduce. For the period October 2020 to February 2021 the IPM staged a growth of ~5% y-o-y as compared to a decline of 2.5% YoY in 1HFY21. The improvement in the IPM growth is largely attributable to the price increase and growth from new products, while the volumes were on the declining trend. Going ahead in FY2022, IPM is expected to grow in double digits (as against expected mid single digit growth in the FY2021) backed by sustained pricing growth and an expected pick up in volumes as well. This augurs well for Ipca's domestic formulations segment from a growth perspective. In the Indian markets, the company has a strong presence in the pain / analgesics, Gatsro – intestinal segments followed by the cardiology. Amongst these, the gastrointestinal segment recorded a strong growth of 14.3% and 9.9% y-o-y in the months of January and February 2021 respectively. While the pain segment recorded a growth of 5% and 2.3% y-o-y respectively for the same period. Though cardiology accounts for a smaller share of the company's revenues, the segment has been one of the fastest growing ones. Also Ipca's domestic formulations segment has outperformed the IPM growth in January and February clocking a strong growth of 12.5% and 9.7% respectively versus the IPM growth of 4.5% and 1.1% respectively. This depicts the company's strong positioning and brand strength in the Indian markets. The domestic formulations accounts for around 45% of FY2020 sales and a strong traction is expected to led to a double digit growth in the formulations sales over the next two years. Ipca sees the domestic business growing by 8%-10% for Q4FY2020, while it looks for 13%-14% growth for FY2022.

Domestic Formulations - Sales trends



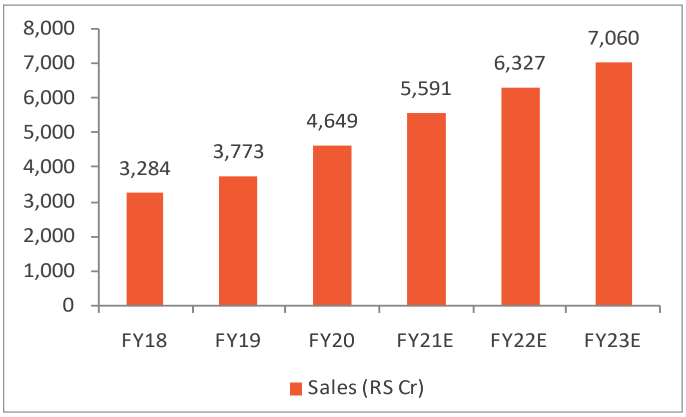
Source: Company, Sharekhan Research

API sales well placed for a strong growth backed by strong demand and easing capacity constraints: Ipca's API segment accounts for around 25% of the overall sales and the API revenues have staged a strong growth with a 42% y-o-y increase for 9MFY21. The growth could be attributable to a sturdy demand for the API's especially from the exports markets (up 48% y-o-y for 9M FY21) while the domestic sales also were up 20% y-o-y. Given the strong demand traction, Ipca's capacities are now operating at close to high utilization levels and witnessing capacity constraints. Ipca is de-bottlenecking its existing capacities, which are likely to ease up capacity constraints. Moreover, the company is putting up a new manufacturing block at the Ratlam plant with a capacity of about 50 MT likely to commence operations in 2HFY2022. While this would help address incremental demand in the near term, commissioning of the Dewas greenfield plant, once commissioned, would provide ample growth visibility ahead. Based on this strong demand traction, IPCA expects API sales in FY2021 to grow by 13%-15% y-o-y.

Dewas greenfield to be ready by FY2022; would enhance the API capacity by 25%: IPCA is expanding its API facilities at Dewas as it looks to reduce dependence on others for API and intermediaries. Currently the integration levels stand at 62% (company has internal APIs for 62% of its formulations), which are up from 55% as of FY2020. Ipca is setting up a new Greenfield plant at Dewas with an outlay of Rs. 300-350 crore, which is expected to add up to 25% capacity in the API space. The Dewas plant would be ready by FY2022 for inspection and the benefits from the new plant could be accrued from FY23 onwards. In addition to this, the 50MT API plant at Ratlam is expected to be ready by end of Q4FY21 / early Q1FY22 and the commercial operations are likely to commence by H2FY2022. Collectively, the commissioning of Dewas and Ratlam plant would ease the capacity constraints and would fuel the growth ahead. Further, Ipca has participated in the performance-linked incentive (PLI) scheme launched by the Government of India and has made applications for Sartans at its Dewas plant. A positive outcome in the form of approval would further add to the growth of API's.

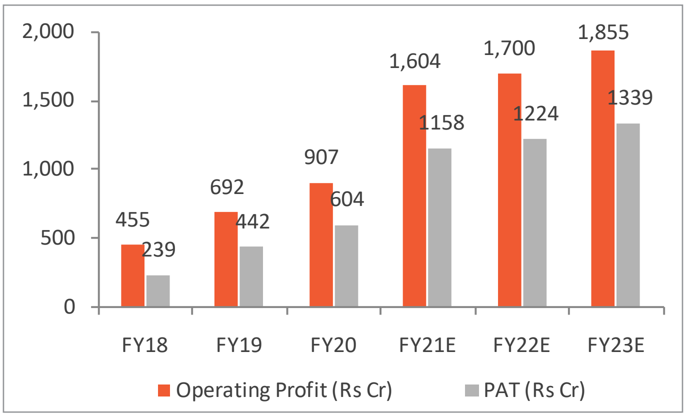
Financials in charts

Sales Trends



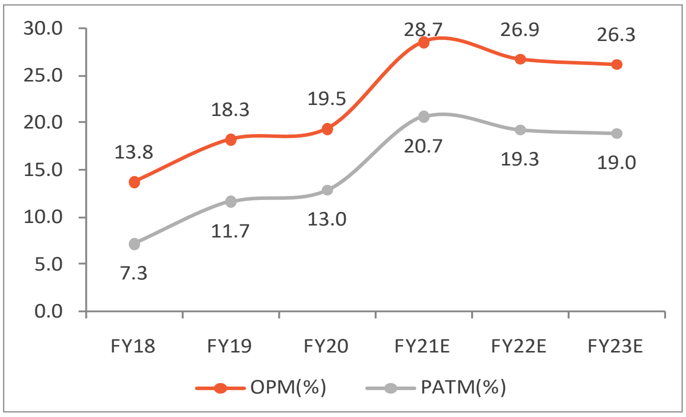
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



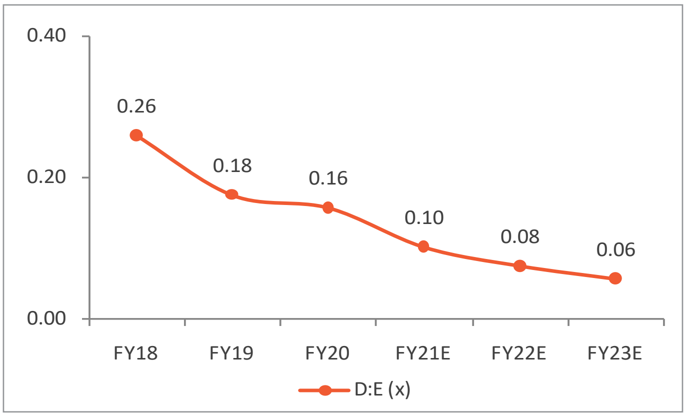
Source: Company, Sharekhan Research

Margin Trends



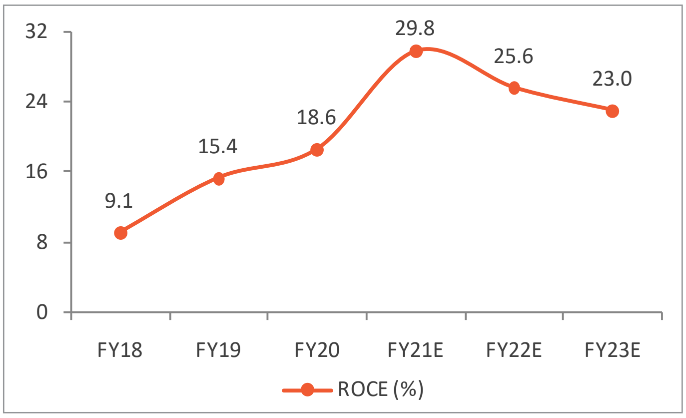
Source: Company, Sharekhan Research

Improving Leverage (D:E)



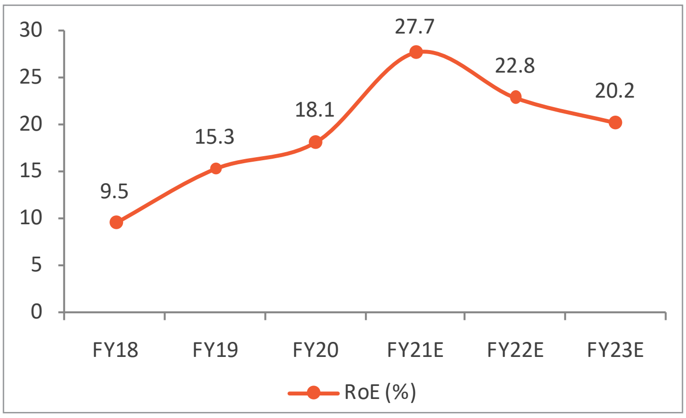
Source: Company, Sharekhan Research

RoCE Trend (%)



Source: Company, Sharekhan Research

RoE (%) Trends



Source: Company, Sharekhan Research

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.

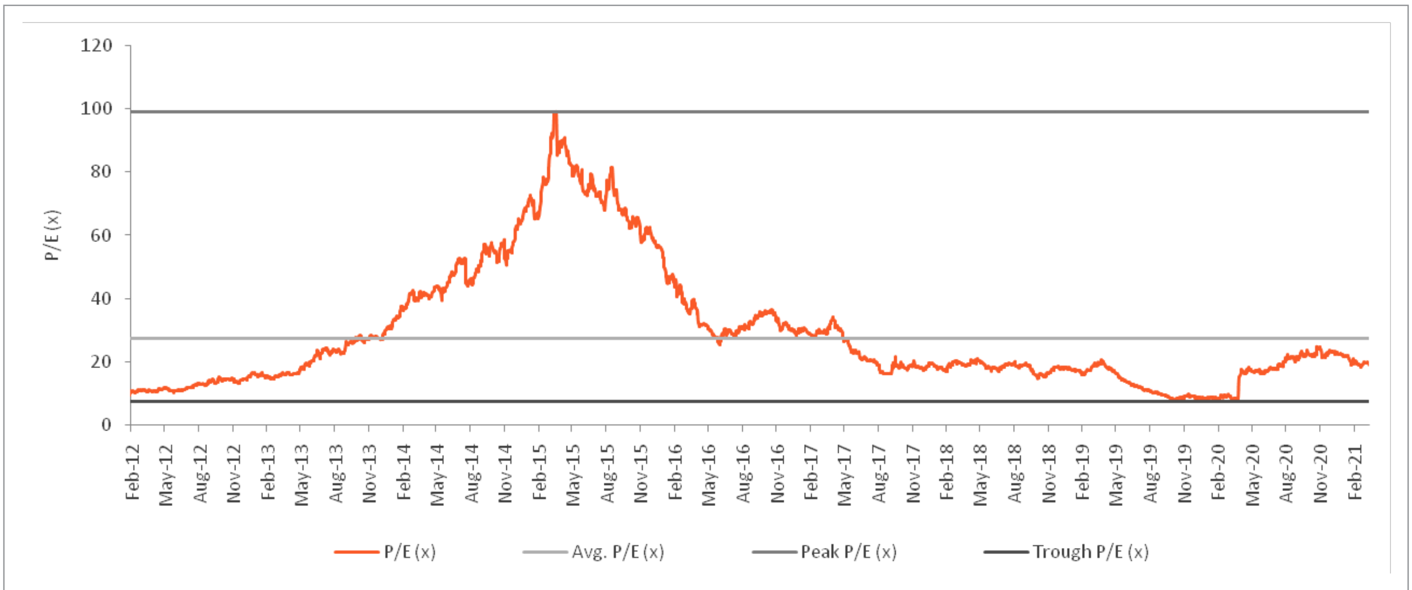
■ Company outlook - Strong earnings prospects

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 capacity constraints. This would fuel growth over the next two years, by FY2023, as 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 the Ratlam facility with a 50MT capacity, which is likely to commence operations by 2HFY2022. The formulations business is also expected to grow at a healthy pace. 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. Sales and PAT are expected to post a 15% and 30% CAGR, respectively, over FY2020-FY2023.

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

Ipca's domestic formulations which account for around 45% of the overall topline of the company is on a strong footing to report a double digit growth over the next two years. Consistent outperformance versus the IPM, strong position in the pain and gastro segments along with a healthy growth in cardiology segment are the key growth drivers for the segment. The API business is witnessing a strong demand traction, which is expected to sustain going ahead. Ipca is facing capacity constraints in its API segment and to ease out the same, in the near term it is de-bottlenecking existing facilities as well as setting up 50 MT API plant at Ratlam. Over the long term, the Dewas expansion is expected to go on stream in FY2023 and would support growth. At CMP, the stock is trading at valuation of 19.2x/17.6x its FY2022E/FY2023E EPS. Strong earnings prospects, a sturdy balance sheet, and healthy return ratios augur well for Ipca. Further over the span of past three months, Ipca has underperformed the Sensex as well as BSE Healthcare index by 21% and 11% respectively, and the stock price has also corrected by ~17%, thus providing a good entry point for investors. Hence we maintain 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 (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
IPCA Labs	1,865	12.6	23,655	39.0	20.3	19.2	26.4	14.6	13.1	18.1	27.7	22.8
Solara Active Pharma Sciences	1249	3.5	4486	38.7	20.3	17.0	19.1	12.1	10.1	10.5	16.8	16.8

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

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

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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