Ipca Laboratories Ltd

Lyka Labs stake acquisition – strategic positive

Pharmaceuticals	Sharekhan code: IPCALAB
Reco/View: Buy ↔	CMP: Rs. 2,060
	Price Target: Rs. 2,675 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 50.34

Updated Oct 08, 2021

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

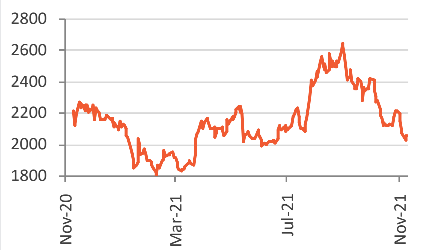
Company details

Market cap:	Rs. 27,330 cr
52-week high/low:	Rs. 2767 / 1786
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	-9.6	-17.7	-8.3	-6.9
Relative to Sensex	-5.5	-21.9	-23.5	-37.9

Sharekhan Research, Bloomberg

Summary

- IPCA Laboratories' (Ipca) board has approved acquisition of 26.57% stake in Lyka Labs for a consideration of Rs 97.89 crore and have also approved entering a joint management control agreement with the promoters of Lyka Labs, thus triggering an open offer.
- The acquisition is astrategic positive for IPCA as it provides entry into lucrative lyophilized injectables business in India and ROW markets, which bodes well as IPCA does not have a presence in this space now.
- Strong position across chronic and acute therapies and a robust demand environment are key growth drivers for the domestic formulations segment.However muted performance of the API business and rising cost pressures could be near term challenges, though long term growth levers are intact.
- We retain Buy recommendation on the stock with unchanged PT of Rs 2,675.

Ipca Laboratories Limited (Ipca) board has approved the acquisition of 26.57% stake in Lyka Labs and along with this they have also approved entering a joint management control agreement with the promoters of Lyka Labs. Consequently, this has triggered an open offer and IPCA has announced to acquire 26% additional equity shares of Lyka Labs. The acquisition provides IPCA an entry in lucrative lyophilized injectables space, which opens up substantial growth opportunities for IPCA ahead.Additionally, improving growth prospects across the acute and chronic therapies, presence in high-growing therapies such as pain, anti-infectives could drive domestic formulations segment performance, which is a key growth driver for IPCA.

- **Acquisition of 26.57% stake in Lyka Labs:** IPCA's board of directors have approved the acquisition of 26.574% stake in the Lyka Labs for a consideration of Rs 97.89 crore and have also approved entering into a joint management control agreement with the promoters of Lyka Labs. This has triggered an open offer to Lyka Labs shareholders and the IPCA has announced to acquire additional 26% stake, the details of the same are awaited. The acquisition provides IPCA an entry in the lucrative lyophilized injectables space across India and RoW markets, which bodes well from a growth perspective
- **Domestic formulations segment poised for a strong growth:** The management expects the formulations segment to be a key growth driver for IPCA largely driven by strong growth in domestic formulations. An impressive performance of covered therapy areas like pain (up 33% ex Covid), cardiovascular (up 13%), anti-bacterials (up 37%), cough and cold (up 95%) as of quarter ending September 2021, could enable IPCA to clock a strong double digit growth in the domestic formulations segment for FY22.
- **Capex plans provide long term growth visibility:** IPCA is in the midst of a capacity expansion plan and has lined up investments of ~Rs 400 crore over the next 3-4 years towards setting up a greenfield plant at Dewas and expansion at existing Ratlam plant. The Dewas greenfield would bring in 25% of incremental capacities and could be ready by Q1FY23 (post which it would undergo regulatory clearances) while theRatlam plant is undergoing validation rounds and would be ready by December 2021. Collectively the capex plans provide ample growth visibility for IPCA.

Our Call

Valuation – Maintain Buy with unchanged PT of Rs. 2,675: The acquisition of 26.57% stake in Lyka Labs and consequent entering in to joint management control agreement is a strategic positive as it provides IPCA an entry into lucrative lyophilized injectables business in India and ROW markets, which bodes well as IPCA does not have a presence in this space now. Also consideration of Rs 97.89 cr for 26.57% stake translates in to reasonable valuations in the light of a marked improvement in Lyka's 1HFY22 and Q2FY22 performance. Also, strong growth prospects exist for the domestic formulations segment which is a key growth driver for IPCA. However muted performance of the API business and rising cost pressures could be near term challenges, but over the long term, commissioning of the Dewas plant and a healthy growth outlook are the key positives. At CMP, the stock is trading at reasonable valuation of 24.3x/20.8x its FY2022E/FY2023E EPS. we retain Buy recommendation on the stock with unchanged PT of Rs 2,675.

Key Risks

1) A delay inregulatory clearance of Pithampur and Pipariya plants and 2) adverse changes in the regulatory landscape could affect its profitability.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Net sales	5,420.0	5,876.5	6,584.1	7,385.2
Operating Profit	1,544.4	1,471.6	1,704.9	1,944.1
OPM (%)	28.5	25.0	25.9	26.3
PAT	1,141.1	1,068.3	1,249.4	1,412.5
EPS (Rs)	90.5	84.7	99.0	112.0
PER (x)	22.8	24.3	20.8	18.4
EV/Ebidta (x)	16.9	17.2	14.2	12.0
RoCE (%)	29.3	23.1	22.6	21.8
RoNW (%)	27.6	20.6	19.7	18.4

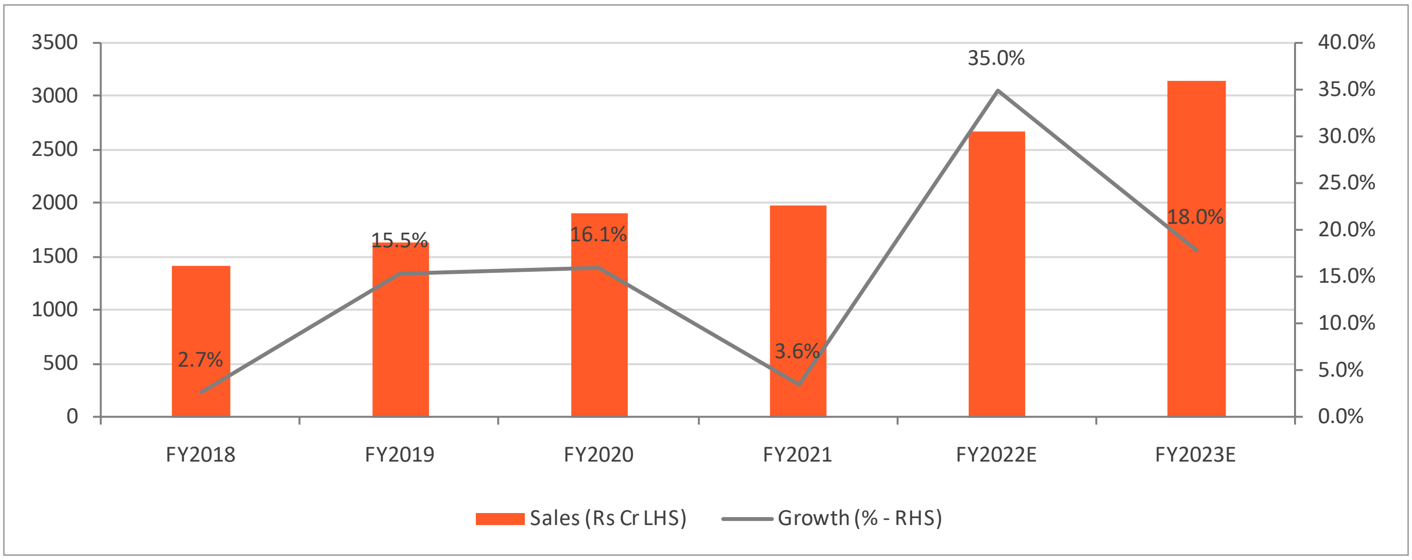
Source: Company; Sharekhan estimates

Board approves acquisition of 26.57% stake in Lyka Labs; acquisition to be strategic positive: The board of directors of IPCA have approved the acquisition of a 26.574% stake of the paid up equity capital of Lyka Labs and along with this have also approved entering in to a joint management control agreement with the promoters of Lyka Labs. Consequently, this has triggered an open offer and IPCA has announced to acquire 26% additional equity shares from its public shareholders. Lyka Labs is engaged in the manufacturing and marketing of injectables, lyophilized injectables and topical formulations. Also,Lyka labs caters to the India as well as Rest of the World markets and has its products registered in several countries with the manufacturing plant based in Ankaleshwar Gujarat. The acquisition of the stake in Lyka Labs is expected to benefit IPCA going ahead as Lyka acquisition would provide IPCA an entry in the lucrative Lyophilized injectables business and could also open cross selling opportunities for other products. Further, as of FY21,Lyka Labs reported revenues of Rs 64.4 cr and a loss of Rs 14.4 cr while for 1HFY21 the revenues and PAT stood at 109.8 cr and 49.4 cr respectively, pointing at a marked improvement. Therefore, entry in the new area of lyophilized injectables across the markets of India and Row is the major synergy for IPCA from the acquisition and we believe this could be a strategic positive, which could unfold going ahead.

Lyka Labs reported a marked improvement in Q2FY2022: Lyka Labs financials have improved remarkably on a y-o-y basis for Q2FY22. The results for the corresponding periods (Q2FY21 and 1HFy21)have been restated to recognize the effect of the merger of wholly owned subsidiary - Lyka Healthcare with Lyka labs limited. The revenues jumped to Rs 65 cr as compared to Rs 12.9 cr in Q2FY21, while the Q2FY22 operating margins at 68% were impressive as compared to 19.3% as of Q2FY21. Consequently, the Pat for Q2 stood at Rs 29.8 cr as compared to loss of Rs 5.8 cr in corresponding quarter. The marked improvement in Q2FY22 financials is also reflected in the H1FY22 results with the revenues growing multifold to Rs 109.8 cr as compared to 26.3 cr (1HFY21) and PAT at Rs 49.5 cr as compared to a loss of 12 cr in H1FY21. The marked improvement in the performance bodes well for Lyka and consequently for IPCA as well.

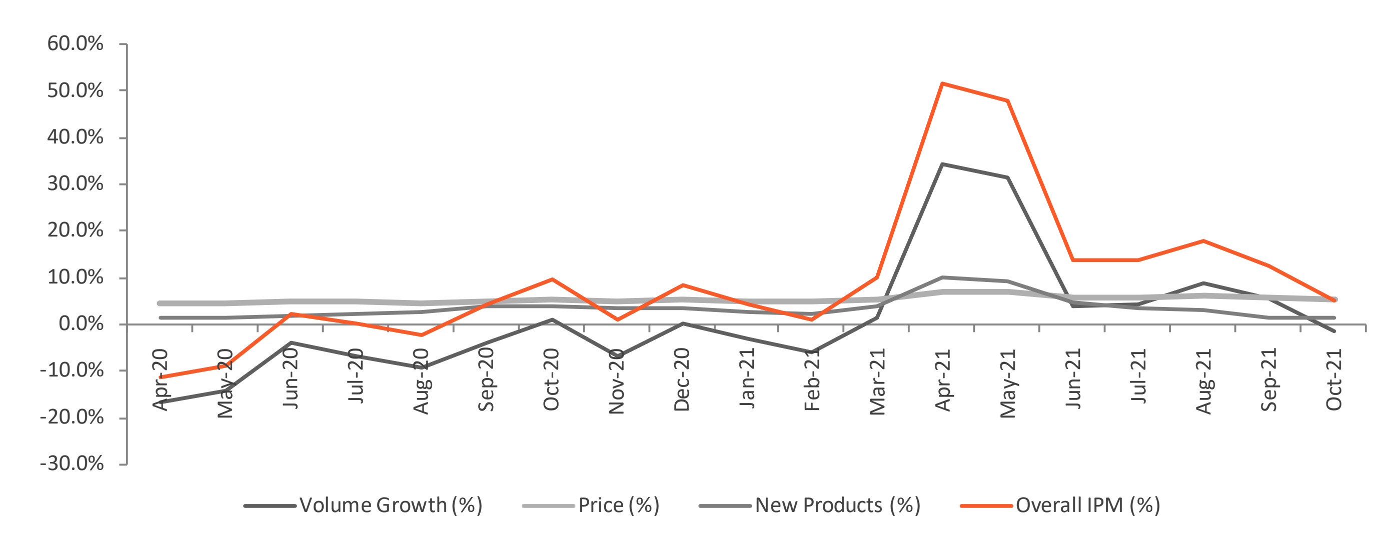
Domestic formulations segment poised for a strong growth: Ipca's overall formulations segment reported 14% y-o-y growthin 1HFY22. Growth in formulations can be attributed to a strong 28% y-o-y growth in domestic formulations, while the exports lagged the overall formulations growth. Going ahead,the management expects the formulations segment to be a key growth driver for the company in FY2022, largely driven by strong growth in the India formulations segment. In FY2021, the India formulations business had a one-time incremental business due to HCQS sales on account of COVID-led higher demand and despite this, Ipca guided for a 16-18% revenue growth from the domestic formulations business for FY2022. In 1HFY2022 the domestic formulations revenues have grown by ~28% y-o-y and the management sees to achieve growth that is higher than guidance for FY22. Strong growth in the covered therapy areas like Pain (up 33% ex Covid), Cardiovascular (up 13%), anti-bacterials (up 37%), Cough and Cold (up 95%) have enabled IPCA to stage a strong growth. Going ahead with the infection levels expected to rise, the acute therapy growth is likely to sustain the string growth momentum. Overall, the domestic business is expected to stage double-digit growth for FY2022 and the management sees revenues beating estimates in FY22.

Domestic Formulations - Sales trends



Source: Company, Sharekhan Research

IPM Growth Trends

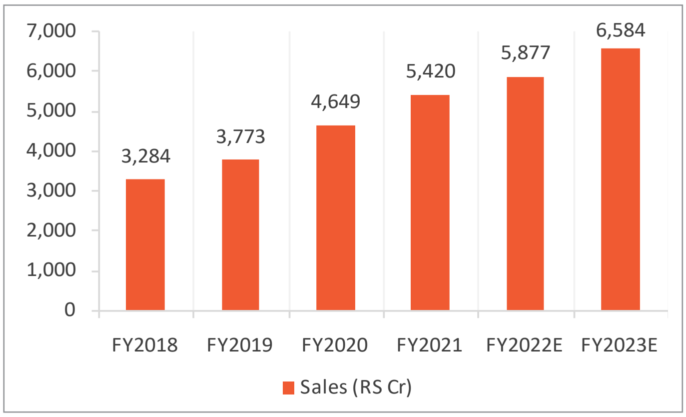


Source: Industry, Sharekhan Research

Dewas greenfield plant to be ready by Q1FY23; Ratlam plant to go on stream Q3FY2022: Ipca is expanding its API facilities at Dewas as it looks to reduce dependence on others for APIs and intermediaries. The company is setting up a new Greenfield plant at Dewas at an outlay of Rs.300 crore-350crore.The company has commenced civil work for the plant, but due to COVID-led delays, the work is progressing at a slower-than-expected pace, leading to delay of three months. Consequently, the Dewas plant is expected to be ready in Q1FY2023; and post this, the plant would undergo inspections by regulators and subject to regulatory clearance. In addition to Dewas, Ipca is in the process of setting up a small API plant at its Ratlam facility, which is ready and now doing validation rounds. The plant is expected to go on stream in December 2021 and is likely to increase the capacity by 10%, While the commissioning of the Dewas plant would bring in incremental 25% of capacities.Overall, the company expects to incur capex of Rs. 400 crore over the next 2-3 years which post commissioning would support the overall growth.

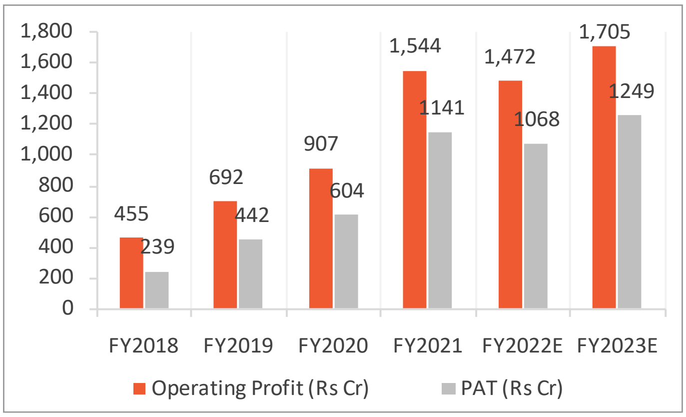
Financials in charts

Sales Trends



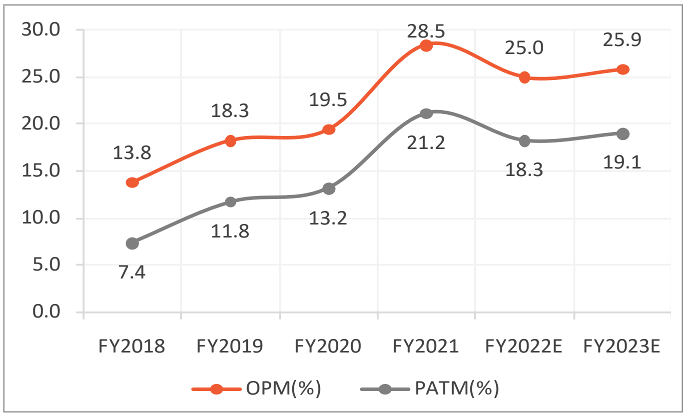
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



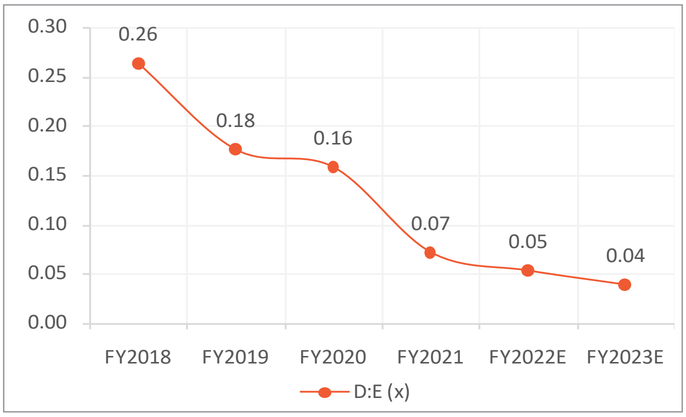
Source: Company, Sharekhan Research

Margin Trends



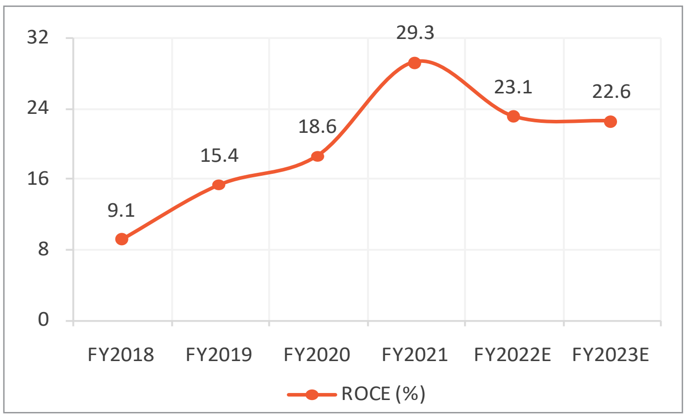
Source: Company, Sharekhan Research

Improving Leverage (D:E)



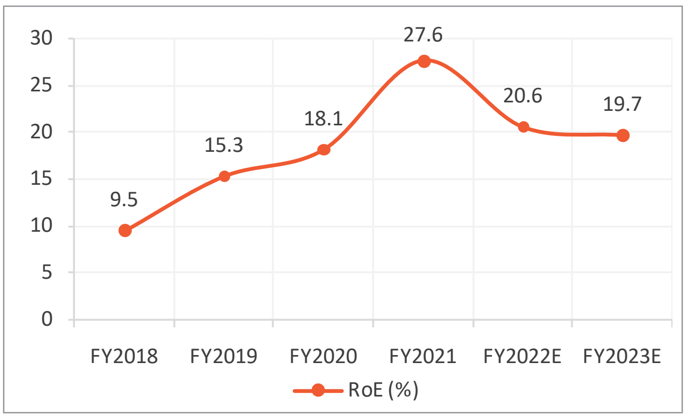
Source: Company, Sharekhan Research

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, 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.

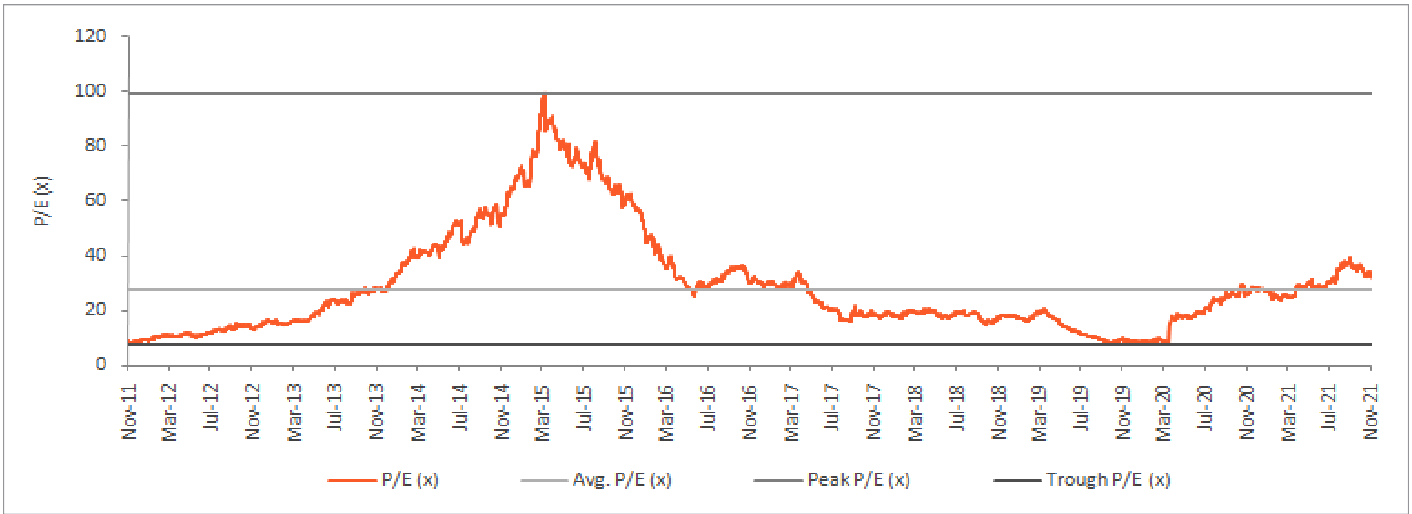
■ Company outlook - Capex plans provide ample growth visibility

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 segment is expected to grow at a healthy pace.The company is witnessing strong demand traction in the API segment and is implementing de-bottlenecking to ease out capacity constraints. 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 Q3FY2022. 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,emerging cost pressures due to higher raw material as well as logistics costs, and time lag to pass on the price increase to the customers coupled with the de-stocking in the key markets of Europe is expected to drag down the growth. Consequently, while near term growth seems to moderate, the long term growth levers are intact.

■ Valuation - Maintain Buy with unchanged PT of Rs. 2,675

Ipca's domestic formulations business, which accounts for ~40% of overall topline, is on a strong footing and the management had guided for double-digit growth of 16-18% in FY2022E, which it expects to now exceed. Strong position across chronic and acute therapies and a robust demand environment are key growth drivers for the domestic formulations segment. Growth prospects for the API segment are also strong, but growth could moderate substantially for FY2022E, due to near term hindrances in the form of impurities in Sartans and a possible demand deferment in Europe. However,in the long term, commissioning of Dewas plant and a healthy outlookwould drive the API segment's performance.However, rising costs pressures due to higher raw material cost and logistics costs could play margins dampeners. However, the recent acquisition of a stake in Lyka Labs provides IPCA an entry in the lyophilized injectables space and this is likely to open substantial growth opportunities going ahead. AtCMP, the stock is trading at valuation of 24.3x/20.8x its FY2022E/FY2023E EPS. Given the long-term growth levers we retain Buy recommendation on the stock with an unchanged PT of Rs 2,675.

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	2,060	12.6	26,131	22.8	24.3	20.8	16.9	17.2	14.2	27.6	20.6	19.7
Torrent Pharma	2816	16.92	47653	38.2	35.4	27.7	21.1	18.8	15.4	23.5	21.3	22.7
Cipla	894.0	80.6	72,086.0	30.0	23.5	19.5	17.2	14.6	12.2	13.9	14.6	16.1

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-malaria with a marketshare of over 34% and 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

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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 and 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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