Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Ipca Laboratories Ltd

Weak quarter; Mixed outlook; Downgrade to Hold

Pharmaceuticals	Sharekhan code: IPCALAB
Reco/View: Hold ↓	CMP: **Rs. 938** / Price Target: **Rs. 1,080** ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Ipca Laboratories Limited (Ipca) reported weak results for the quarter and numbers missed estimates. Revenue grew by 15.5 y-o-y, while PAT declined by 19% y-o-y.
- Ipca expects strong traction in the domestic business to sustain and aims to stage 10-12% growth for FY2023, while outlook for generics as well as the institutional business looks stressed.
- Dewas plant is expected to commence commercial production with contribution from the plant likely to start by 2HFY2024 and full impact expected by FY2025.
- Given the apparent challenges in exports markets, higher cost pressures, and delay in Dewas commissioning, performance in the subsequent quarters is expected to be subdued. We downgrade our rating to Hold with a revised PT of Rs. 1080.

Ipca Laboratories (Ipca) reported weak and lower-than-expected results for Q4FY2022. Higher-than-expected raw-material cost led to lower gross margin and, thus, operating profit margin (OPM) dropped on a y-o-y basis. Further lower other income and higher depreciation led to PAT declining by double digits and missing estimates. Revenue grew by 15.5% y-o-y and PAT declined by 19% y-o-y. Management commentary was mixed as prospects in the domestic business are strong, while that in exports seem stressed. Further, due to expected elevated cost pressures, OPM for FY2023 is expected to be flat. Given aapparent challenges in export business, higher cost pressures, and delay in Dewas commissioning, performance in the subsequent quarters is expected to be subdued.

Key positives

- Domestic formulations sales grew strongly by 27% y-o-y to Rs. 551.8 crore, outpacing the industry's growth.
- Domestic API business grew by 51.6% y-o-y, pointing at a strong growth momentum.

Key negatives

- Gross margin declined by 270 bps y-o-y, leading to a 350-bps decline in OPM.
- API exports declined by 13.5% y-o-y and Ipca reported Rs. 20 crore sales returns for Sartans due to detection of Azhido impurities.

Management Commentary

- The domestic formulations segment is expected to sustain its strong performance and management expects 10-12% growth in FY2023. Growth prospects for the institutional and generics segment appear challenging.
- Dewas' Greenfield expansion has been delayed and Ipca has started manufacturing one intermediate product, while it is in the process of commencing the second product. Management expects the plant to contribute from 2HFY2024 and full impact of the same is expected by FY2025, which is at a distance.
- Based on bright growth prospects for the domestic business and a subdued outlook for the institutional and generics segment, IPCA has guided for revenue growth of 10-12% for FY2023, while due to elevated cost pressures, management has guided for margin of 22-22.5% for FY2023 (FY2022 OPM - 22.5%).

Revision in estimates – Ipca's Q4FY2022 earnings declined by double digits, marred by higher cost pressures and results missed estimates. Based on this and mixed management commentary pointing towards near-term pressures, we have revised downwards our estimates in the range of 8% - 12% for FY2023E/FY2024E.

Our Call

Valuation – Cost pressures apparent, downgrade to Hold: Ipca's domestic formulations business is expected to report double-digit growth in FY2023. However, prospects for the exports business looks muted, backed by an expected subdued performance of the generics as well as institutional business. Cost pressures are also expected to be on the higher side, thereby leading to flat EBITDA margin for FY2023. At the CMP, the stock is trading at valuation of 23.3x/19.1x its FY2023E/FY2024E EPS. Given the apparent challenges in exports markets, higher cost pressures, and delay in Dewas commissioning, performance in the subsequent quarters is expected to be subdued. Hence, we downgrade our rating on the stock to Hold with a revised price target (PT) of Rs. 1,080.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY2021	FY2022	FY2023E	FY2024E
Net sales	5,420.0	5,829.8	6,605.4	7,587.1
Operating Profit	1,544.4	1,309.3	1,486.2	1,798.1
OPM (%)	28.5	22.5	22.5	23.7
PAT	1,141.1	903.2	1,015.8	1,241.2
EPS (Rs.)	45.2	35.8	40.3	49.2
PER (x)	20.7	26.2	23.3	19.1
EV/EBIDTA (x)	15.3	18.3	15.7	12.5
RoCE (%)	29.3	19.5	18.5	19.7
RoNW (%)	27.6	17.9	17.1	17.5

Source: Company; Sharekhan estimates

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 Updated Feb 08, 2022				50.34
Severe Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 23,793 cr
52-week high/low:	Rs. 1,383 / 917
NSE volume: (No of shares)	4.4 lakh
BSE code:	524494
NSE code:	IPCALAB
Free float: (No of shares)	6.8 cr

Shareholding (%)

Promoters	46.3
FII	12.9
DII	30.0
Others	10.8

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-6.1	-3.3	-7.3	-15.1
Relative to Sensex	-1.1	0.4	1.3	-21.3

Sharekhan Research, Bloomberg

Q4 OPM contracts, results miss estimates: Ipca reported weak results for Q4FY2022, below our estimates. Higher-than-expected raw-material cost led to lower gross margin, thus resulting in a y-o-y decline OPM. Further, lower other income and higher depreciation led to PAT declining by double digits and missing our estimates. Revenue at Rs. 1,289 crore grew by 15.5% y-o-y, driven by domestic formulations, which grew by 27% y-o-y. Formulations revenue increased by 16% y-o-y, while API sales declined marginally by 1% y-o-y due to 52% growth in domestic API, which arrested the decline in exports. OPM at 17% (missed estimates at 19.5%) declined by 350 bps y-o-y, largely backed by a 270-bps decline in gross margin, which can be attributed to higher input prices. Moreover, other expenses (as a % of sales) inched up on a y-o-y basis. Therefore, operating profit declined by 4% y-o-y to Rs. 219.6 crore. Given a 27% y-o-y drop in other income and a 16% increase in depreciation, PAT at Rs. 130 crore declined by 19% y-o-y and missed our estimates.

Q4FY2022 Conference Call Highlights

- **Domestic formulations to stage double-digit growth:** Ipca's domestic formulations revenue grew strongly in double digits by 27% y-o-y to Rs. 551 crore, thus outpacing IPM growth. Strong growth can be attributed to double-digit growth in acute therapies. Therapy wise, the pain, cardio, and anti-bacterial segments grew by 32%, 13%, and 43% y-o-y, respectively, for the quarter, while cough and cold, neurology, and derma led the growth, staging 71%, 36%, and 20% y-o-y growth, respectively. Going ahead, management expects the domestic formulations segment to be a key growth driver for the company. This would be backed by growth in existing therapy areas as well as from the four new divisions, which the company plans to set up. Accordingly, the medical representative (MR) strength is expected to go up by 1,200 in addition to the existing 4,800 MRs. Further, price hike for NLEM products, though is initiated from April 2022, due to higher stocks, the effect of the incremental prices would be visible from June 2022. Overall, the strong growth trajectory in the domestic formulations segment is expected to sustain ahead as well and Ipca aims to report 12-13% growth in the domestic formulations segment in FY2023.

- **Dewas Greenfield validations delayed, likely to start contributing by 2HFY2024:** 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-350 crore. The Dewas project is spread across two facilities and the plant is ready. Ipca has commenced the production of one intermediate product from Dewas plant and is soon looking to commence manufacturing the second one as well. Management expects the commercial batches to start by August 2022 and post that validations would begin, pointing a delay. Ipca sees Dewas plant to start contributing meaningfully by 2HFY2024, which is at a distance. Accordingly, full impact of the same would be visible in FY2025, which is a delay of almost one year. Commissioning of the Dewas plant would bring in incremental 25% of capacities, which could enable Ipca to improve the backward integration levels.

- **Institutional Business:** Ipca's institutional business sales for the quarter stood at Rs. 79 crore, 5% y-o-y growth. The company's institutional business consists of the anti-malaria medicine supplies. During the quarter, on account of delayed shipments and non-availability of containers for freight, deliveries were delayed, which led to muted revenue growth. However, management expects challenges to stay in the near term and expects flat growth from the institutional business in FY2023.

- **Europe/UK distribution challenges:** Ipca is confronting challenges in Europe/UK business with respect to the distribution. The company currently has only one distributor and has started its own distribution network in the region. Currently, the company has around seven products, which are being approved and are marketed in the UK and are expecting 6-7 product approvals. In this process of transition, the run rate from the business has declined to Rs. 25 crore from a level of Rs. 60 crore. Consequently, as the company is setting up its distribution front end and is in the process of getting product registrations. Hence, UK business growth is expected to be constrained in the near term.

- **API segment's** sales declined by 1% y-o-y to Rs. 257.8 crore because of a 14% dip in API exports, while domestic API sales grew by 52% y-o-y. The decline in exports can be attributed to detection of Azido's impurities in Sartans. In Q4FY2022, the company has sales returns worth Rs. 20 crore and is expecting some sales returns in Q1FY2023 as well, thus pointing at subdued performance from Sartans. Overall, for FY2022, the API segment's sales declined by 11%; and overall, management expects 10% growth in APIs FY2023, which seems to be on the lower side after a dip of 11% in FY2022, pointing towards a low base.

- **Merger of wholly owned subsidiary company:** The board of directors has announced to merge wholly owned subsidiary companies – Ramdev Chemicals and Tonira Exports with Ipca. The merger scheme is subject to receipt of necessary approvals.
- **Guidance:** The domestic formulations segment is expected to stage a strong performance and management expects double-digit revenue growth, backed by expansion of products and portfolio as well as recruitments of MRs. However, outlook for exports formulations are expected to be under stress, largely due to muted performance of the generics as well as the institutional business, which is expected to stage muted growth/flat growth. Based on this, management expects revenue to grow by 10-12% for FY2023. Considering the recruitment of MRs for India business, pointing at elevated employee costs, and inflationary cost pressures, including raw-material cost and freight, energy, and other costs, management has guided for EBITDA margin to be at 22-22.5% for FY2023, which compares to 22.5% for FY2022. Further, given the high base in Q1FY2022, Q1FY2023 performance could also be subdued.

Results (Consolidated) Rs cr

Particulars	Q4FY2022	Q4FY2021	YoY %	Q3FY2022	QoQ %
Net sales	1289.1	1114.7	15.6	1430.5	-9.9
Operating profit	219.6	228.9	-4.1	307.8	-28.7
Other income	14.54	19.92	-27.0	12.93	12.5
EBIDTA	234.1	248.8	-5.9	320.7	-27.0
Interest	3.38	1.7	98.8	1.43	136.4
Depreciation	60.94	52.5	16.1	58.65	3.9
PBT	169.8	194.6	-12.8	260.7	-34.9
Tax	28.76	30.93	-7.0	57.33	-49.8
Net profit (Reported)	130.5	161.2	-19.1	197.0	-33.8
Margins			**BPS**		**BPS**
OPM (%)	17.0	20.5	-350.3	21.5	-448.5
Net profit margin (%)	10.1	14.5	-434.1	13.8	-364.8
Tax rate (%)	16.9	15.9	104.7	22.0	-505.6

Source: Company, Sharekhan Research

Geographical Sales Break-Up Rs cr

Formulation	Q4FY2022	Q4FY2021	YoY %	Q3FY2022	QoQ %
Domestic	551.8	433.61	27.3	645.27	-14.5
Exports	**346.5**	**338.0**	**2.5**	**347.5**	**-0.3**
Branded Generics	102.71	101.01	1.7	109.24	-6.0
Institutional	79.92	76.22	4.9	59.2	35.0
Generics	163.86	160.77	1.9	179.06	-8.5
Total Formulation	**898.3**	**771.6**	**16.4**	**992.8**	**-9.5**
APIs					
Domestic	76.99	50.79	51.6	85.56	-10.0
Exports	180.85	209.15	-13.5	223.82	-19.2
Total APIs	**257.8**	**259.9**	**-0.8**	**309.4**	**-16.7**
Subsidiaries	120.65	73.74	63.6	102	18.3
OOI	12.32	9.37	31.5	26.32	-53.2
Total Sales	**1289.1**	**1114.7**	**15.6**	**1430.5**	**-9.9**

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 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 – Long-term growth levers intact

Ipca is a fully integrated Indian pharmaceutical company, manufacturing a wide array of formulations and APIs for various therapeutic segments. The domestic formulations business is expected to grow at a healthy pace and is likely to be a key growth driver for the company. The company is witnessing strong demand traction in the API segment and is implementing de-bottlenecking to ease out capacity constraints. Over the next one year, Dewas expansion would come on stream and drive the topline. Moreover, the company has set up a new API plant at Ratlam facility with a 50MT capacity, which is one the verge of ommercialization. The expected improvement in the formulation business, increased opportunities in the API space, and healthy traction from the institutional segment indicate strong earnings potential for the company. In the near term, emerging cost pressures due to higher raw material and logistics costs and time lag to pass on the price increase to customers coupled with de-stocking in key markets of Europe are expected to drag down growth. Consequently, while near-term growth seems to moderate, long-term growth levers are intact.

■ Valuation – Cost pressures apparent, downgrade to Hold

Ipca's domestic formulations business, which accounts for ~40% of overall topline, is on a strong footing and management expects double-digit growth in FY2023, backed by growth across therapy areas, setting up of new divisions, and expanding MR strength. However, the prospects for the exports business seem muted, backed by an expected subdued performance of the generics as well as the institutional business. Further, given the detection of Azhido's impurities in Sartans, Ipca has reported sales returns in Q4 and expects it in Q1FY2023 as well. Overall, after a decline in API sales in FY2022, management sees growth of 10% in APIs in FY2023, which seems to be lower after a year of decline. While prospects in the domestic business are strong, growth prospects for exports seem stressed. Moreover, given the expected elevated cost pressures in the form of higher employee and other expenses, EBITDA margin for FY2023 are expected to be flat as against an expansion factored in earlier. Further, Dewas Greenfield validations are getting delayed, contribution from the Dewas plant is expected to start in 2HFY2024 and full impact is likely in FY2025, which is still at a distance. Ipca's Q4FY2022 earnings declined by double digits, marred by higher cost pressures and results missed estimates. Bases on this and a mixed management commentary pointing towards near-term pressures, we have revised downwards our estimates to 8-12% for FY2023E-FY2024E. At the CMP, the stock is trading at valuation of 23.3x/19.1x its FY2023E/FY2024E EPS. Given the apparent exports challenges, higher cost pressures, and delay in Dewas commissioning, performance in the subsequent quarters is expected to be subdued. Hence, we downgrade our rating on the stock to Hold with a revised PT of Rs. 1080.

Peer valuation

Companies	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBITDA (x)			RoE (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
IPCA Labs	938	12.6	23,793	26.2	23.3	19.1	18.3	15.7	12.5	17.9	17.1	17.5
Caplin Point Laboratories	722.0	7.6	5,471.0	17.7	14.7	12.6	11.3	9.2	7.4	23.1	22.5	21.5
Alembic Pharmaceuticals	741.0	19.7	14,565.0	19.8	17.1	12.5	14.4	10.8	7.9	14.0	14.7	17.5

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-malaria with a market share 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

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 into 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 and 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

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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by BNP PARIBAS

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