Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Ipca Laboratories Ltd

Disappointing quarter; Muted outlook

Pharmaceuticals	Sharekhan code: IPCALAB		
Reco/View: Hold ↔	CMP: Rs. 1,016	Price Target: Rs. 1,080 ↔	

↑ 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 Feb 08, 2022

Severe Risk

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

Source: Morningstar

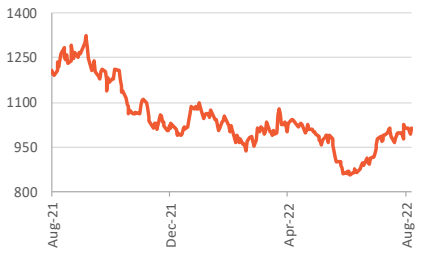
Company details

Market cap:	Rs. 25,758 cr
52-week high/low:	Rs. 1,383 / 831
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	3.0	4.7	2.1	-15.9
Relative to Sensex	-5.0	-3.6	2.3	-23.7

Sharekhan Research, Bloomberg

Summary

- Ipca Laboratories Limited (Ipca) reported disappointing results for the quarter and numbers missed estimates.
- Ipca expects healthy traction in the domestic business to sustain and aims to stage 12% growth for FY2023, while outlook for generics as well as institutional business looks stressed.
- Dewas plant is expected to commence commercial production with contribution from the plant likely to start by FY2024 and full impact expected by FY2025.
- Ipca has lowered OPM guidance for FY2023 to 21% as against the earlier guidance of 22.5%. Ipca has reported 17% OPM for Q1FY2023 and guidance of 21% (though lowered) points at implied OPM to be improving in the subsequent quarters as compared to Q1FY2023. We retain our Hold recommendation with an unchanged PT of Rs. 1,080.

Ipca Laboratories Limited (Ipca) reported disappointing results for Q1. Numbers were below estimates. Higher-than-expected raw-material cost and higher other expenses resulted in OPM contracting on a yoy basis. Further, a higher tax rate resulted in PAT halving for the quarter and missing estimates. Management commentary was mixed as prospects in the domestic business are healthy, while that in exports seem stressed. Further, due to expected elevated cost pressures, OPM for FY2023 is expected to decline as compared to FY2022. Given apparent challenges in the export business, higher cost pressures, and delay in Dewas commissioning, growth in the subsequent quarters could moderate.

Key positives

- Domestic formulations sales grew strongly by 12% y-o-y to Rs. 685 crore, outpacing the industry's growth.
- The total formulations segment's sales grew by 3% y-o-y.

Key negatives

- Gross margin declined by 160 bps y-o-y to 63.5%.
- OPM declined by 962 bps y-o-y on account of a 680bps y-o-y increase in other expenses/sales.
- API exports declined by 9.5% y-o-y.

Management Commentary

- The domestic formulations segment is expected to sustain its healthy 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. Management expects the plant to contribute from FY2024 and full impact of the same is expected by FY2025, which is at a distance.
- Management has lowered its OPM guidance for FY2023 to 21% as against the earlier guidance of 22.5%, backed by elevated cost pressures and likely higher employee cost. Ipca has reported 17% OPM for Q1FY2023 and the guidance of 21% (though lowered) points at implied OPM to be improving in the subsequent quarters as compared to Q1FY2023 and this bodes well.

Revision in estimates – Ipca reported disappointing results for Q1 and numbers were below estimates. OPM guidance of 21%, though lowered, points at implied margins to be improving in the subsequent quarters as compared to Q1FY2023 and this bodes well. Factoring this, we have fine-tuned our earnings estimates for FY2023E and FY2024E.

Our Call

Valuation – Retain Hold with an unchanged PT of Rs 1080: 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. At the CMP, the stock is trading at valuation of 30.5x/22.9x its FY2023E/FY2024E EPS. Cost pressures are also expected to be on the higher side, thereby leading to a likely decline in OPM for FY2023 vs. FY2022. However, lowered OPM guidance points at implied margins to be improving in the subsequent quarters as compared to Q1FY2023 and this bodes well. We retain our Hold recommendation on the stock with an unchanged 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	6,522.8	7,492.2
Operating Profit	1,544.4	1,309.3	1,369.8	1,738.2
OPM (%)	28.5	22.5	21.0	23.2
PAT	1,141.1	903.2	841.2	1,118.2
EPS (Rs)	45.2	35.8	33.3	44.3
PER (x)	22.5	28.4	30.5	22.9
EV/EBITDA (x)	16.6	19.8	18.6	14.3
RoCE (%)	29.3	19.5	17.0	19.5
RoNW (%)	27.6	17.9	14.4	16.3

Source: Company; Sharekhan estimates

Disappointing performance: Ipca reported disappointing results for Q1 and numbers were below estimates. Higher-than-expected raw-material cost and higher other expenses resulted in OPMs contracting on a y-o-y basis. Further, a higher tax rate resulted in PAT halving for the quarter and missing estimates. Revenue at Rs. 1,586 crore grew by 1.3% y-o-y, driven by domestic formulations, which grew by 12% y-o-y, while the 14% and 17% decline in branded and institutional exports, respectively, resulted in a meagre 3% growth in the formulations segment's sales, while API's revenue dropped by 10% y-o-y. Operating profit margin (OPM) at 17% (missed estimates at 20%) declined by 962 bps y-o-y, largely backed by a 160 bps decline in gross margins, which can be attributed to higher input prices as well as 680bps y-o-y increase in other expenses/ sales. Therefore, operating profit declined by 35.4% y-o-y to Rs. 269.2 crore and missed estimates. Tax rate for the quarter was higher at 33% vs. 18.6% in Q1FY2022. Consequently, PAT at Rs. 143 crore halved on a y-o-y basis and missed estimates.

Q1FY2023 Conference Call Highlights

- **Domestic formulations to stage double-digit growth:** Ipca's domestic formulations revenue grew strongly in double digits by 12% y-o-y to Rs. 685 crore, thus outpacing IPM growth. Strong growth can be attributed to double-digit growth in acute therapies. 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 onwards and hence Q2 would be reflecting the full impact. 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 FY2024:** 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 the next year, subject to regulatory approvals falling in place. 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 backward integration levels.

- **Institutional Business:** Ipca's institutional business sales for the quarter stood at Rs. 96.99 crore, 16.7% y-o-y decline. The company's institutional business consists of the anti-malaria medicine supplies and currently has been under pressure. Management expects pressures to sustain ahead. 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 the institutional business to decline by 8-10% for 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 8-10 product approvals. In this process of transition, the run rate from the business has declined substantially. 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, though FY2024 could witness growth.

- **API segment's** sales declined by 9.5% y-o-y to Rs. 375 crore because of a 12% dip in API exports, while domestic API sales were almost flat at Rs. 89.27 crore. The decline in exports can be attributed to detection of Azido's impurities in Sartans, which have been clarified by EU regulators that the impurities no longer exists. Overall, for FY2022, the API segment's sales declined by 11%; and overall, management expects 5% growth in APIs in FY2023, which seems to be on the lower side after a dip of 11% in FY2022.

- **FY2023 guidance lowered, but implied OPM points at improvement in subsequent quarters:** IPCA has lowered its growth guidance for the domestic formulations business and has now guided for 12-13% growth as against earlier guidance of 15%. Weakness in the anti-malaria segment and partial effect of the NLEM price hikes have led to lowering the guidance. Moreover, due to weakness in the anti-malaria segment, the institutional business's revenue is expected to decline by 8-10% for FY2023. IPCA has also further lowered its OPM guidance for FY2023 to 21% as against the earlier guidance of 22.5% for FY2023, backed by higher selling and marketing expenses, elevated freight cost, and higher employee cost due to addition of 1,200 MRs in FY2023. Ipca has reported 17% OPM for Q1FY2023 and the guidance of 21% (though lowered) points at implied OPM to be improving in the subsequent quarters as compared to Q1FY2023 and this bodes well.

Results (Consolidated) — Rs cr

Particulars	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Net sales	1585.7	1565.8	1.3	1289.1	23.0
Operating profit	269.2	416.5	-35.4	219.6	22.6
Other income	22.11	21.02	5.2	14.54	52.1
EBIDTA	291.3	437.6	-33.4	234.1	24.4
Interest	6.94	1.82	281.3	3.38	105.3
Depreciation	61.71	55.87	10.5	60.94	1.3
PBT	222.7	379.9	-41.4	169.8	31.2
Tax	74.26	70.77	4.9	28.76	158.2
Net profit (reported)	143.1	306.7	-53.4	130.5	9.6
Margins			**BPS**		**BPS**
OPM (%)	17.0	26.6	-962.4	17.0	-5.5
Net profit margin (%)	9.0	19.6	-	10.1	-109.9
Tax rate (%)	33.3	18.6	-	16.9	-

Source: Company; Sharekhan Research

Geographical Sales Break-Up – Quarterly — Rs cr

Formulation	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Domestic	**684.8**	**612.97**	**11.7**	**551.8**	**24.1**
Exports	**401.8**	**441.8**	**-9.1**	**346.5**	**16.0**
Branded Generics	92.88	108.55	-14.4	102.71	-9.6
Institutional	96.99	116.48	-16.7	79.92	21.4
Generics	211.94	216.77	-2.2	163.86	29.3
Total Formulation	**1086.6**	**1054.8**	**3.0**	**898.3**	**21.0**
APIs					
Domestic	89.27	89.95	-0.8	76.99	16.0
Exports	285.78	324.47	-11.9	180.85	58.0
Total APIs	**375.1**	**414.4**	**-9.5**	**257.8**	**45.5**
Subsidiaries	116.46	87.19	33.6	120.65	-3.5
OOI	7.62	9.41	-19.0	12.32	-38.1
Total Sales	**1585.7**	**1565.8**	**1.3**	**1289.1**	**23.0**

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 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 50MT capacity, which is on the verge of commercialisation. 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 – Growth guidance lowered, retain Hold:** Ipca's domestic formulations business accounts for ~40% of overall topline and management expects ~12% 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. Overall, after a decline in API sales in FY2022, management sees growth of 5% in APIs in FY2023, which seems to be lower after a year of decline. While prospects in the domestic business are better, 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 is expected to decline as compared to FY2022 as IPCA has lowered the growth guidance. Further, Dewas Greenfield validations are getting delayed, contribution from the Dewas plant is expected to start in FY2024, and full impact is likely in FY2025, which is still at a distance. Ipca reported disappointing results for Q1 and numbers were below estimates. Higher-than-expected cost pressures resulted in OPMs contracting, and while higher tax rate resulted in PAT halving down. OPM guidance of 21%, though lowered, points at implied margins to be improving in the subsequent quarters as compared to Q1FY2023 and this bodes well. Factoring this, we have fine-tuned our earnings estimates for FY2023E and FY2024E. At the CMP, the stock is trading at valuation of 30.5x/22.9x its FY2023E/FY2024E EPS. We retain our Hold recommendation on the stock with an unchanged PT of Rs. 1,080.

Peer valuation

Particulars	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	1,016	12.6	25,758	28.4	30.5	22.9	19.8	18.6	14.3	17.9	14.4	16.3
Caplin Point Laboratories	805.0	7.6	6,098.0	19.7	16.5	13.9	12.8	10.5	8.3	23.1	22.3	21.8

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, 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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