

February 16, 2023

RESULT REPORT Q3 FY23 | Sector: Pharmaceuticals & Healthcare

IPCA

Margin pain ending; reinstate BUY from ADD

Result Synopsis

IPCA reported a largely in-line revenue and margin quarter as 9-17% growth across domestic and branded markets was offset by rebound in costs on YoY basis.

IPCA has spent bulk of the last few quarters, like most other pharma cos, under the shadow of elevated COGS coupled with revival of fixed and promotional expenses. On a 3-year CAGR, staff and other expenses are now clocking 13-15% rise annually between 9m FY20 (pre- Covid clean base) and 9m FY23 which makes us believe fixed expenses have largely completed their catch up on the low marketing/promotional expense phase of FY21/22. Current fixed cost structure would include 1) Dewas related costs 2) at least part costs of 1500 MRs hired in last few quarters 3) higher than average freight and one-time testing expenses related to impurity. We reckon most of these costs are reversible in nature on top of a softening COGS scenario which can add ~150-200bps to gross margin. While 4Q should see some impact from full impact of NLEM-led reduction, possibility of price hikes again from April'23 linked to WPI would offset some of the decline. API business is also expected to rebound strongly as inventory overstocking runs off and IPCA enjoys scale in its API business thereby aiding margin recovery. We expect a strong rebound in FY24/25 margin as wash out year for earnings draws to a close. We had downgraded IPCA to ADD in our Q1 FY23 update on back of limited near term catalysts (lack of margin traction in FY23, inflated costs). We reckon most of these have played out and a likelihood of fixed costs growth tapering off, API rebound on the cards and gross margin improvement have emerged as key triggers in FY24/25. While we cut FY23/24 estimates by 20-35% in light of still-lingering margin weakness in Q3, believe reversal in some of the factors that plagued the company in FY23 could be in the offing; upgrade to BUY from ADD with target PE of 25x on FY25 EPS for an unchanged TP Rs1,100.

Result Highlights

In line revenue quarter though margin weakness still persists

Domestic growth 9% YoY and branded growth at 17% YoY; anti-malarial decline and weakness in cardiac is pulling down India business

Gross margin had slight decline QoQ as higher cost inventory works its way

Fixed expenses ramp up continue YoY though likely end of any further sharp rise

Exhibit 1: Actual vs estimates

Rsmn	Actual	Estimate		% Variation		Remarks
		YES Sec	Consensus	YES Sec	Consensus	
Sales	15,460	15,279	15,247	1.2	1.4	In line numbers but margin weakness persists along with similar growth likely in Q4 FY23
EBITDA	2,159	2,282	2,726	-5.4	-20.8	
EBITDA Margin (%)	14.0	14.9	17.9	-98 bps	-392 bps	
Adjusted PAT	1,156	1,367	1,649	-15.4	-29.9	

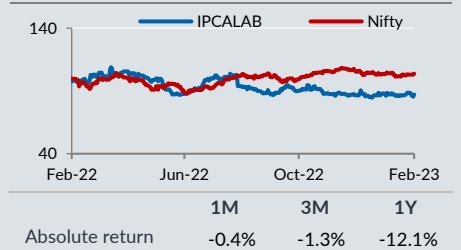
Source: Company, YES Sec

Reco	: BUY
CMP	: Rs 864
Target Price	: Rs 1,100
Potential Return	: +27.6%

Stock data (as on Feb 16, 2023)

Nifty	18,036
52 Week h/l (Rs)	1095 / 824
Market cap (Rs/USD mn)	214012 / 2588
Outstanding Shares (mn)	254
6m Avg t/o (Rs mn):	268
Div yield (%):	0.5
Bloomberg code:	IPCA IN
NSE code:	IPCALAB

Stock performance



Shareholding pattern (As of Dec '22 end)

Promoter	46.3%
FII+DII	44.5%
Others	9.2%

Δ in stance

(1-Yr)	New	Old
Rating	BUY	ADD
Target Price	1,100	1,100

Δ in earnings estimates

	FY23e	FY24e	FY25e
EPS (New)	19.9	31.8	44.1
EPS (Old)	30.9	40.4	-
% change	-35.7%	-21.2%	-

Financial Summary

(Rs mn)	FY23E	FY24E	FY25E
Revenue	61,856	69,141	78,057
YoY Growth	6.1	11.8	12.9
EBITDA	9,619	13,435	18,047
YoY Growth	-26.5	39.7	34.3
PAT	5,042	8,077	11,187
YoY Growth	(43.0)	60.2	38.5
ROE	9.6	13.4	16.1
EPS	19.9	31.8	44.1
P/E	43.5	27.1	19.6
BV	232.4	260.2	300.3
EV/EBITDA	22.2	15.7	11.3

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Exhibit 2: Quarterly snapshot (Consolidated)

Rs mn	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23	y/y (%)	q/q (%)
Revenue	14,305	12,891	15,857	16,010	15,460	8.1	(3.4)
Expenditure	11,227	10,698	13,165	13,403	13,301	18.5	(0.8)
- RM	4,986	4,262	5,787	5,748	5,618	12.7	(2.3)
- Staff Cost	2,837	2,977	3,227	3,192	3,184	12.3	(0.2)
- Other exp	3,404	3,458	4,151	4,464	4,499	32.1	0.8
Operating Profit	3,078	2,193	2,692	2,606	2,159	(29.9)	(17.2)
OPM(%)	21.5	17.0	17.0	16.3	14.0	-756 bps	-232 bps
Other Income	129	145	221	362	309	138.9	(15)
Depreciation	587	609	617	637	666	13.5	4
Interest	14	34	69	93	108	658.0	16
PBT	2,607	1,696	2,227	2,238	1,693	(35.0)	(24.3)
Tax	573	288	743	770	537	(6.3)	(30.2)
PAT	2,033	1,408	1,484	1,468	1,156	(43.1)	(21.3)
Exceptional	64	106	54	29	78	22.0	-
Reported PAT	1,970	1,302	1,431	1,439	1,078	(45.2)	(25.1)

Source: Company, YES Sec

KEY CON-CALL HIGHLIGHTS

Guidance & outlook

- Margin to remain in the range of 21% (+150bps from gross margin, 200bps from flat promotional costs + operating leverage to kick in as no major increase in costs) in FY24 and may rise 1% every year thereafter
- API business should double over next few years driven by new capacity and new product launches; domestic formulation business should grow 1.5x IPM. ROW should grow at 15% given the base of Rs5bn
- KSM prices has shown softening trends recently
- 4Q growth of 10-12% driven by branded formulations, generic and API. Margin to be impacted due to full NLEM price reduction of 15% but margin should improve next fiscal
- Input cost rise was seen in solvents and Aluminum foil. Do not foresee gross margin to be a concern and is a short term issue
- API – 4% growth in Q3 and by 4Q expect all declines should be covered and end FY23 at flat as impurity issues like Nitroso amines is well behind
- Institutional business in the range of Rs3bn + scope for further product of Rs600mn but then buying of other products may dip so range of Rs3-3.5bn
- Not seeing any further dip in API and KSM prices; with demand picking up, KSM prices may move up a bit along with better API prices
- ETR of 29-30% kind of range after ruling on disallowances of promotional costs
- FY24 capex of Rs4-5bn – only new project is Rs1.5bn biotech in MP meant for developed markets, rest is maintenance capex. Current R&D expense on biosimilar is Rs250mn

API

- Excess inventory of APIs in developed markets is getting depleted so API may have a good year in FY24; not included increase that may come from Dewas where developed market business would only start after inspection
- Most of the high cost inventory would be depleted by Q4 except for one KSM of anti-malarial where procurement prices were 40% higher so that impact would last another 6 months. Hence gross margin on API prices should improve in FY24
- All pending impurity-driven issues on Valsartan and Losartan have been resolved

Quarterly highlights

- Anti-malarial sales down 37% in 9m FY23
- IPCA is ranked 13th in acute and 18th in chronic; outpaced industry in both acute and chronic in Dec
- With addition of 1500 reps, hope to further increase market share in domestic business
- Have 104 SKUs which are under NLEM, where price drop impact would be seen in Q4 though by April price rise in non NLEM should offset the decline
- Excluding incentives, staff costs have gone up more than 13% as incentives had been very high last year
- Manufacturing expenses has gone up by 4% which should normalize as also Dewas plant costs is debited to P&L
- Energy cost increase has been 45% in current year due to increase in coal and other sources; shipping costs were also high in H1 but cooled down in Q3
- Analytical costs required for testing impurities has also increased a lot as had to check all APIs, formulations for Nitroso amines impurity. But these should not increase any further
- Promotional costs are up 40-45% during the year but would remain at these levels with increase in business next year which would help margin
- Cardiac growth is only 4% and should be higher; anti-bacterial there is a marginal decline; CNS is growing by 18%, cough and cold by 10% and ophthalmology by 17%
- Not finalized any capex for the Nagpur site
- Key subsidiaries: US front end Bayshore – procuring from third party and selling in US but is in loss currently; Onyx – Significant site expansion this year and expect GBP13-14mn with 27% margin. Trophic Wellness – nutraceutical co and is profitable. Ramdev – FDA approved site is being merged and once formulation facility gets cleared can start sourcing APIs from Ramdev site

FINANCIALS

Exhibit 3: Balance Sheet

Y/e 31 Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Equity capital	254	254	254	254	254
Reserves	46,763	54,666	58,694	65,755	75,927
Net worth	47,017	54,920	58,947	66,009	76,181
MI	145	769	769	769	769
Debt	855	4,515	2,000	500	500
Deferred tax liab (net)	1,336	1,526	1,526	1,526	1,526
Total liabilities	49,352	61,730	63,242	68,804	78,976
Goodwill	466	542	542	542	542
Fixed Asset	22,607	26,698	29,134	31,245	32,063
Investments	3,222	4,557	4,557	4,557	4,557
Net Working Capital	15,449	16,313	20,923	23,618	26,916
Inventories	15,948	18,580	19,714	22,036	24,877
Sundry debtors	8,118	9,108	9,664	10,802	12,195
Other current assets	2,715	3,285	3,402	3,803	4,293
Sundry creditors	(6,662)	(5,577)	(5,917)	(6,614)	(7,467)
ST borrowings	(1,540)	(4,005)	(1,959)	(1,959)	(1,959)
Other CL	(2,098)	(4,061)	(3,093)	(3,457)	(3,903)
ST provisions	(1,031)	(1,015)	(888)	(992)	(1,120)
Cash	7,589	13,600	8,066	8,822	14,878
Def tax assets	20	20	20	20	20
Total Assets	49,352	61,730	63,242	68,804	78,976

Source: Company, YES Sec

Exhibit 4: Income statement

Y/e 31 Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Revenue	54,200	58,297	61,856	69,141	78,057
Operating profit	15,444	13,092	9,619	13,435	18,047
Depreciation	(2,092)	(2,324)	(2,564)	(2,889)	(3,182)
Interest expense	(90)	(77)	(317)	(148)	(148)
Other income	628	666	1,192	1,192	1,192
Profit before tax	13,890	11,356	7,931	11,591	15,910
Taxes	(2,401)	(2,248)	(2,458)	(3,245)	(4,455)
Adj. profit	11,488	9,109	5,472	8,345	11,455
Exceptional items	(88)	(269)	(430)	(269)	(269)
Net profit	11,400	8,840	5,042	8,077	11,187

Source: Company, YES Sec

Exhibit 5: Cashflow Statement

Y/e 31 Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Profit before tax	13,890	11,356	7,931	11,591	15,910
Depreciation	2,092	2,324	2,564	2,889	3,182
Def tax assets (net)	(102)	190	-	-	-
Tax paid	(2,401)	(2,248)	(2,458)	(3,245)	(4,455)
Working capital Δ	(4,348)	(864)	(4,610)	(2,695)	(3,298)
Other operating items	(88)	(269)	(430)	(269)	(269)
Operating cashflow	9,042	10,490	2,996	8,271	11,070
Capital expenditure	(3,245)	(6,491)	(5,000)	(5,000)	(4,000)
Free cash flow	5,797	3,999	(2,004)	3,271	7,070
Equity raised	357	78	(0)	(0)	(0)
MI	9	624	-	-	-
Investments	(1,101)	(1,335)	-	-	-
Debt financing/disposal	(650)	3,660	(2,515)	(1,500)	-
Dividends paid	(1,015)	(1,015)	(1,015)	(1,015)	(1,015)
Net Δ in cash	3,397	6,011	(5,534)	756	6,055

Source: Company, YES Sec

Exhibit 6: Du-pont analysis

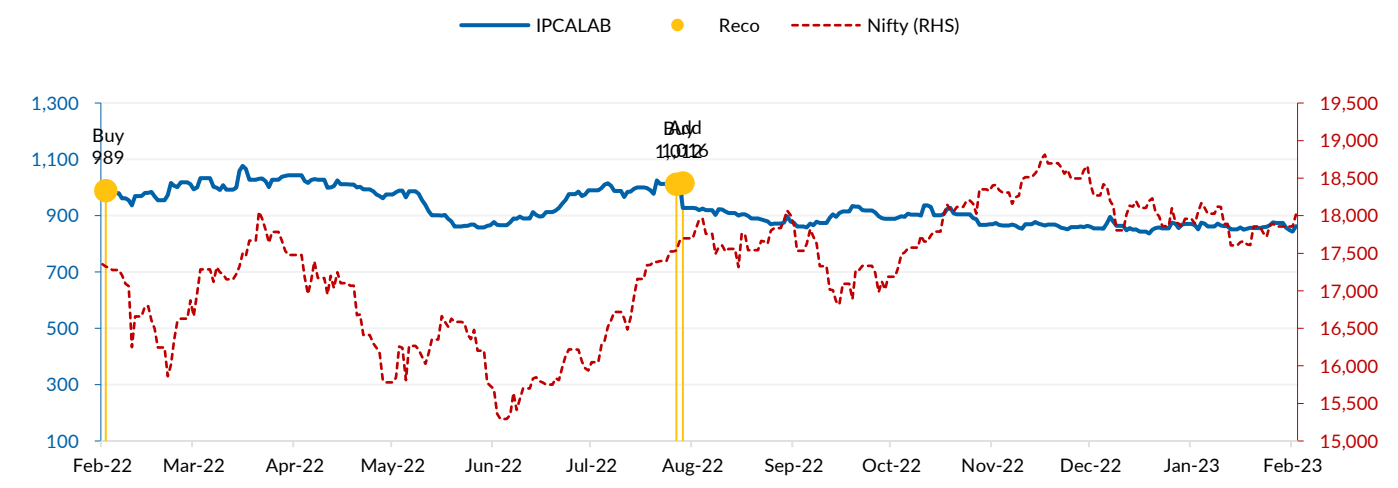
Y/e 31 Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Tax burden (x)	0.83	0.80	0.69	0.72	0.72
Interest burden (x)	0.99	0.99	0.96	0.99	0.99
EBIT margin (x)	0.26	0.20	0.13	0.17	0.21
Asset turnover (x)	0.97	0.86	0.82	0.89	0.90
Financial leverage (x)	1.35	1.33	1.32	1.25	1.22
RoE (%)	27.6	17.9	9.6	13.4	16.1

Exhibit 7: Ratio analysis

Y/e 31 Mar	FY21	FY22	FY23E	FY24E	FY25E
Growth matrix (%)					
Revenue growth	16.6	7.6	6.1	11.8	12.9
Op profit growth	70.3	(15.2)	(26.5)	39.7	34.3
EBIT growth	83.2	(18.2)	(27.9)	42.3	36.8
Net profit growth	88.9	(22.5)	(43.0)	60.2	38.5
Profitability ratios (%)					
OPM	28.5	22.5	15.6	19.4	23.1
EBIT margin	25.8	19.6	13.3	17.0	20.6
Net profit margin	21.2	15.6	8.8	12.1	14.7

Y/e 31 Mar	FY21	FY22	FY23E	FY24E	FY25E
RoCE	31.5	20.6	13.2	17.8	21.7
RoNW	27.6	17.9	9.6	13.4	16.1
RoA	20.5	13.4	7.3	10.7	13.2
Per share ratios					
EPS	44.9	34.8	19.9	31.8	44.1
Dividend per share	4.0	4.0	4.0	4.0	4.0
Cash EPS	53.2	44.0	30.0	43.2	56.6
Book value per share	185.3	216.5	232.4	260.2	300.3
Valuation ratios					
P/E	19.2	24.8	43.5	27.1	19.6
P/CEPS	4.7	4.0	3.7	3.3	2.9
P/B	4.0	3.8	3.5	3.2	2.8
EV/EBIDTA	13.8	16.0	22.2	15.7	11.3
Payout (%)					
Dividend payout	17.3	19.8	31.0	28.0	28.0
Tax payout	8.9	11.5	20.1	12.6	9.1
Liquidity ratios					
Debtor days	55	57	57	57	57
Inventory days	107	116	116	116	116
Creditor days	45	35	35	35	35

Recommendation Tracker



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