

# Ipca Lab

**Rs312**  
**OUTPERFORMER**

## RESULT NOTE

**Mkt Cap: Rs39bn; US\$866m**

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**Result:** Q3FY11

**Comment:** Below estimates; Field force investments impact margins

**Last report:** 22 October 2010 (Price Rs298; Recommendation: Outperformer)

### Key consolidated financials

As on 31 March	Net sales (Rs m)	Net profit (Rs m)	EPS (Rs)	% growth	PER (x)
FY08	10,510	1,360	10.9	9	28.7
FY09	12,838	1,008	8.1	(26)	38.7
FY10	15,597	2,083	16.7	107	18.7
FY11E	18,526	2,494	20.0	20	15.6
FY12E	22,218	3,010	24.1	21	13.0

Source: IDFC Securities Research

## Key Result Highlights

- IPCA laboratories (Ipca) Q3FY11 reported financials lagged estimates on back of slightly muted topline growth and subdued operating margins. Revenues grew by 18%yoy to Rs4.6bn below our estimates (at Rs4.74bn). EBITDA margins declined by 330bps yoy to 19.5% for the quarter (v/s our estimates at 21.7%). Forex gains (at Rs112m) boosted profitability to some extent. Overall, Net profits grew by 10%yoy to Rs640m below our estimates (at Rs664m).
- Ipca's, net sales grew by 18%yoy to Rs4.6bn with formulation and API sales contributing 74% and 26% of total sales respectively. Ipca's formulation business grew by 21%yoy to Rs3.4bn with domestic formulation sales registering 12%yoy growth, while, export formulation sales grew by 33% to Rs1.7bn for the quarter.
- Excluding tender business, Ipca's domestic branded business grew by 17%yoy in Q3FY11 as against 20-22% growth clocked over 1HFY11. Ipca did not record any government tender (anti-malarial) sales during the quarter against ~Rs70mn recorded last year. Besides tender sales, all key segments registered superior growth rates.
- Ipca's top 3 segments namely Anti-diabetic, CVS and anti-malarial grew by 28%, 15% and 31%yoy over 9MFY11. While, Anti-bacterial, GI and dermatology grew by 9-11%yoy. Nephrology and Urology, the two new therapeutic segments recently introduced clocked Rs30m each for the quarter, in line with management's expectations.
- Ipca's API businesses after registering de-growth in Q2FY11 registered 9%yoy growth in Q3FY11. API exports grew by 15%yoy to Rs865m, while, domestic sales declined by 5%yoy to Rs322m for the quarter.
- Ipca's international branded business continues to do well with Russia also beginning to show momentum finally. Russia sales grew 43% for the quarter and the management believes that it can sustain high growth rates going forward. Over 9MFY11, Russian operations registered flat revenues (at Rs530m). However, management remains positive on the future prospects guiding for 30% growth rates hereon. Ipca currently markets 14 products in the Russian markets. Ipca's LatAm, Middle East and West African operations grew by 76% (at Rs50m), 9% (at Rs170m), and 16%yoy (at Rs220m) respectively over 9MFY11. South East Asia contributed Rs150m.

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- Ipca's generic business continues to do well due to strong growth in tender business as well as solid growth in US business. US sales were ~Rs748m up from ~Rs450mn over 9FY11. EU operations contributed Rs1.7bn (3%yoy growth), while, South Africa, Australia and New Zealand grew by 35%, 155% and 142%yoy respectively on a smaller base over a 9month period.
- Management remains confident on institutional tender business and expects to clock ~Rs700-850m of tender sales in FY11 and Rs1.3-2bn in FY12.
- Ipca has received MHRA (UK) approval for its Indore SEZ facility, while expects WHO approval in Q4FY11. However, Ipca management refrained from providing any timelines for the US FDA approval. Ipca intends to utilize the Indore SEZ facility to service UK markets and WHO tenders until it receives approval from US FDA. This should enable the company to recover the Rs240-250mn annual fixed costs being incurred on running the plant in the interim.
- EBITDA for the quarter stood at Rs910m below our estimates (at Rs1.03bn) on back of lower operating margins. EBITDA margins declined by 330bps yoy to 19.5% for the quarter (v/s our estimates at 21.7%). Management attributed higher employee and marketing related costs due to field force addition and freight costs primarily contributing to margin contraction.
- Ipca has added 2000 employees to its field force over past two years including 1200 employees over FY11 taking the total field force strength to ~5000. Of the 1200 field force added recently, Ipca added 1000 personnel in existing divisions whereas 100 each in nephrology and urology divisions. Ipca management cited the field force strength had largely stabilized and expects to add only 400-500 employees over next two years.
- Ipca realized Rs112m of forex gains during the quarter boosting profitability. Majority of the forex gains were on unrealized gains on the hedges (Rs68m) and another Rs44m of M2M gains on liabilities. Ipca continues to hedge its export receivables 52% of its anticipated exports over next 12month period hedged at ~USD/INR 48.
- Effective tax rate for the quarter stood at 23% below our estimates (at 25%). Overall, net profits grew by 10%yoy to Rs640m below our estimates (at Rs664m).
- Ipca has guided to incur a capex of Rs2-2.2bn for FY11 and FY12 respectively.
- For FY11, Ipca management guides to clock Rs1.85bn of revenues implying 21.6% revenue growth for Q4FY11. Besides, Ipca remains confident to clock 20% revenue growth in FY12 and operating at improved margins over FY12 as recent field force additions begin to contribute positively.

## Valuations and view

Ipca's Q3FY11 number's disappointed on operational front with EBITDA margins (330bps yoy decline) below our estimates. However, we see recent dip in EBITDA margins in Q3FY11, more of a blip, and a reflection of higher marketing expenses and substantial field force addition undertaken by the company over past couple of quarters. We expect the benefits of these investments to be visible from H2FY12 onwards. This combined with the likely FDA approval of the SEZ facility providing boost to US business (currently a bleed of Rs240-250mn annually) along with expected scale-up in tender business, promises exciting times for Ipca in FY12. Ipca remains one of the most competitive mid cap business models in the pharma business on back of its superior API capabilities and a scalable diversified global formulations business. Maintain earning estimates and reiterate Outperformer with price target of Rs339 (17x FY11E, 14.1x FY12E). Ipca remains one of our top picks in pharma space.

## Quarterly results

Particulars (Rs m)	Q2FY10	Q3FY10	Q4FY10	Q1YF11	Q2FY11	Q3FY11	Comments
<b>Net Sales</b>	<b>4,303</b>	<b>3,957</b>	<b>3,678</b>	<b>4,180</b>	<b>5,183</b>	<b>4,664</b>	Revenues were marginally below our estimates (at Rs4.74bn)
Operating Expenses	3,281	3,054	2,992	3,468	4,003	3,754	
COGS	1,737	1,604	1,577	1,748	2,044	1,912	
as % to sales	40.4	40.5	42.9	41.8	39.4	41.0	
Staff Cost	574.4	541.0	530.4	657.5	699.8	649.3	
as % to sales	13.4	13.7	14.4	15.7	13.5	13.9	
Other Expenses	970.5	908.7	884.6	1061.8	1258.7	1192.5	
as % to sales	22.6	23.0	24.0	25.4	24.3	25.6	
<b>EBITDA</b>	<b>1021.2</b>	<b>903.1</b>	<b>686.0</b>	<b>712</b>	<b>1,180</b>	<b>910</b>	
EBITDA %	24	23	19	17	22.8	19.5	EBITDA margins sharply below estimates (at 21.7%)
Forex gains / (losses)	(6)	(17)	18	(29)	288	112	
Other Income	5	9	(0)	6	8	4	
Depreciation	117	119	117	129	137	142	
Interest	71	53	59	49	62	56	
PBT	833	724	528	512	1,277	828	
Provision for Taxation	195	141	152	123	337	188	
<b>PAT</b>	<b>639</b>	<b>583</b>	<b>376</b>	<b>389</b>	<b>940</b>	<b>640</b>	
<b>yoy growth (%)</b>							
Net Sales	24	26	16	16	20	18	
EBITDA	23	27	27	(1)	16	1	
Net Profit	75	151	376	(12)	1	(12)	

Source: IDFC Securities Research

## Revenue break-up

Particulars(Rs m)	Q3FY10	Q3FY11	%chg yoy
Formulations	2,846	3,446	21
Domestic	1,589	1,775	12
Exports	1,257	1,671	33
API's	1,092	1,187	9
Domestic	338	322	(5)
Exports	755	865	15

Source: Company

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