

22 January 2008

**BUY**

Price **Rs701** Target Price **Rs965**

Sensex -20,687

**Price Performance**

(%)	1M	3M	6M	12M
Absolute	9	16	(3)	9
Rel. to Sensex	19	15	(13)	(12)

Source: Bloomberg

**Stock Details**

Sector	Healthcare
Reuters	IPCA.BO
Bloomberg	IPCA@IN
Equity Capital (Rs mn)	251
Face Value	Rs10
52 Week H/L	Rs 794/545
Market Cap(Rs bn)	17.6
Daily Avg Volume (No of shares)	31346
Daily Avg Turnover (US\$m)	0.5

**Shareholding Pattern (%)**

Promoters	46.0
FII/NRI	1.3
Institutions	33.6
Private Corp.	7.4
Public	11.6

Source: Capitaline

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**Ipca Laboratories Ltd.**Result  
Update**Strong growth visibility**

Ipca Labs. (Ipca) reported Q3 FY08 results, ahead of our expectation. Revenues increased by 21% to Rs2.81bn driven by strong performance in branded formulation segments (Domestic business) and improved performance of its UK business. EBIDTA margins for the quarter improved by 40 bps to 21.8% on the back of 100 bps reduction in employee cost and improved product mix. PAT grew by 10% to Rs383mn in Q3FY08. Lower growth in PAT in Q3FY08 was on the back of reduction in other income by 94% to Rs5.8mn V/S Rs94.8mn in Q3FY07. Other income in Q3FY07 was on account of license income (Rs60mn) and one time contract research income of Rs25mn. Diluted EPS for Q3FY08 stood at Rs15.3 (up by 10% over corresponding period). However, AEPS (After deducting other income) grew by 48% to Rs15 V/S Rs10.1 in Q3FY07. On account of robust operating performance, we have revised our earning estimates by 3% for FY08E and FY09E respectively. We also introduce our FY10E estimates with revenues of Rs14397mn and earnings of Rs2201 mn. At CMP of Rs 701, the stock is trading at 9.5x FY09E and 8x FY10E earnings. We upgrade our recommendation to BUY with a price target of Rs965 based on 11x FY10E EPS of Rs87.7. Key risk to our call remains the currency appreciation.

**Focus on branded formulations continued to drive growth**

Revenues have grown by 21% to Rs.2818mn on the back of strong performance in domestic business ~ grew by 20% ~ on account of consistent performance in chronic segments. Company has also received a tender business of Rs90mn for the first time from the govt. for anti-malarial range. Export business grew by 14% driven by sustained growth in semi-regulated markets and improved performance of its UK operations. We expect Ipca's Europe business to further strengthen on the back of new product introductions backed by own APIs resulted improved margins. We believe that Ipca's strategic focus on branded formulations will continue to drive growth going ahead.

**US initiatives will contribute from FY09E onwards**

Ipca along with its alliance partner 'Ranbaxy' has received 5 approvals in US market. Currently these products are manufactured at Ranbaxy's Ohm laboratories, US. Because of capacity constraints, the revenues from these products are insignificant, which we expect to improve going forward. Ipca is setting up a Greenfield facility in SEZ at Indore, which should be ready by Apr'07. Company's Piperia plant has been inspected by USFDA and management expect approval of the same with in next one month. We believe with this approval, company will start manufacturing there US approved product from this facility, which will contribute significantly in its business. Company has also filed 11 ANDAs in the US and expects to file 4 more by April 08. Ipca is filing 6-8 ANDAs every year and we expect US to contribute \$20mn and \$25mn in FY09E and FY10E respectively.

**EBIDTA margins to sustain at 22% level**

EBIDTA margins have improved by 40bps to 21.8% in Q3FY08 from 21.4% in Q3FY07 on account of 100 bps reductions in employee cost and improved product mix. Though the raw material cost has gone up by 190 bps but still company was able to maintain operating margins because of reduction in other expenses by 160 bps.

**Financials**

Year	Net Sales	EBIDTA		PAT	EPS	ROE	P/E	EV/	P/BV	Div. Yld
End	(Rs mn)	Core	(%)	(Rs mn)	(Rs)	(%)	(x)	EBIDTA (X)	(x)	(%)
FY07	9533	2019	21.2	1246	49.7	29.6	14.1	9.9	3.7	0.8
FY08E	11040	2428	22.0	1518	60.5	28.4	11.6	8.1	3.0	1.1
FY09E	12704	2819	22.2	1852	73.9	27.8	9.5	6.8	2.4	1.9
FY10E	14397	3209	22.3	2201	87.7	26.5	8.0	5.8	1.9	2.0

## Lower growth in PAT because of reduction in other income

PAT grew by 10% to Rs383mn in Q3FY08 as compared to Rs348mn in Q3FY07. Lower growth in PAT was on account of reduction in other income by 94% to Rs5.8mn V/S Rs94.8mn in Q3FY07. Other income in Q3FY07 was on account of license income (Rs60mn) and one time contract research income of Rs25mn. Diluted EPS has grown by 10% to Rs15.3 in Q3FY08 (Rs13.9 in Q3FY07). However, AEPS (After deducting other income) grew by 48% to Rs15 V/S Rs10.1 in Q3FY07. On standalone basis, DEPS for 9M FY08 is almost equivalent to the DEPS of full year of FY07 (Rs48.7 in FY07).

## Revising FY08E and FY09E numbers and introducing FY10E estimates

Post better than expected Q3FY08 results, we are upgrading our FY08E and FY09E earning estimates by 2.9% respectively. We believe that continuous focus in high margins branded formulation business, recovery in UK business and improved product mix towards life style segment would enable the company to sustain EBIDTA margins at 22% level. We also introduce FY10E estimates with revenues of Rs14397mn and PAT of Rs2201mn accruing into a fully diluted EPS of Rs87.7. Our FY10E estimates factor the contribution of US business to the tune of \$25mn on the back of aggressive ANDA filing backed by own DMF.

### Revised Estimates

	FY08E	FY09E	FY10E
<b>Revenue (Rs mn)</b>			
Old Estimate	10962	12605	
New Estimate	11040	12704	14397
% Change	0.7%	0.8%	
<b>EBIDTA Margins</b>			
Old Estimate	21.7%	21.9%	
New Estimate	22.0%	22.2%	22.3%
% Change	30 bps	30 bps	
<b>PAT</b>			
Old Estimate	1475	1801	
New Estimate	1518	1852	2201
% Change	2.9%	2.8%	
<b>EPS (Rs)</b>			
Old Estimate	58.8	71.8	
New Estimate	60.5	73.9	87.7
% Change	2.9%	2.9%	

## Outlook and Valuation

We continue to be very positive on the growth story of Ipca and believe that the business profile of the company has improved substantially in the last 2-3 years. We expect it to further improve with strategic focus on branded formulations segment, geographical expansions in semi-regulated markets (a 500+ sales people network across multiple semi-regulated markets (excluding India)), new product launches in fast growing life style segments and focus on European and US markets. Going forward, its focus in the US market will become growth driver from FY09E onwards. We believe that Ipca has remained undervalued as compared to its peers mainly because of poor profitability growth in FY03-06. With strong visibility of an earning growth, 30% ROE, no fears of dilution, we believe that Ipca is an excellent opportunity. At CMP of Rs 701, the stock is trading at 9.5x FY09E and 8x FY10E earnings. We upgrade our recommendation to BUY with a price target of Rs877 based on 10x FY10E EPS of Rs87.7.

## Key Financials Rs mn

Income Statement Y/E, Mar (Rs. m)	Standalone					Consolidated			
	Q3FY08	Q3FY07	Y-o-Y Gr.(%)	Q2FY08	Q-o-Q Gr.(%)	FY07	FY08E	FY09E	FY10E
Net Sales	2818	2325	21%	3001	-6%	9533	11040	12704	14397
<b>Expenses</b>	2202	1827	21%	2275	-3%	7514	8612	9884	11189
<b>Raw Materials</b>	1234	970	27%	1234	0%	3992	4634	5329	6034
<b>% of sales</b>	43.8	41.7	5%	41	7%	42	42	42	42
<b>Employee cost</b>	345	307	12%	365	-6%	1172	1313	1483	1661
<b>% of sales</b>	12.2	13.2	-7%	12	1%	12	12	12	12
<b>Other expenses</b>	624	550	13%	677	-8%	2350	2666	3072	3493
<b>% of sales</b>	22.1	23.7	-7%	23	-2%	25	24	24	24
EBIDTA	616	498	24%	726	-15%	2019	2428	2819	3209
EBIDTA %	21.8	21.4	40 bps	24.2	(240) bps	21.2	22.0	22.2	22.3
<b>Other income</b>	6	95	-94%	3	71%	65	35	37	37
<b>Interest</b>	55	54	2%	52	7%	247	240	198	135
<b>Depreciation</b>	81	74	10%	80	2%	295	326	343	359
<b>PBT</b>	484.9	464.2	4%	597.7	-19%	1543.1	1897.2	2315.5	2750.6
<b>Total Tax</b>	101.5	115.8	-12%	143.5	-29%	294.0	379.4	463.1	550.1
<b>Effective tax rate (%)</b>	20.9	24.9	-16%	24.0	-13%	19.1	20.0	20.0	20.0
<b>PAT</b>	383.4	348.4	10%	454.2	-16%	1249.1	1517.7	1852.4	2200.5
<b>E/O items</b>	0.0	0.0		0.0		7.0	0.0	0.0	0.0
<b>RPAT</b>	383.4	348.4	10%	454.2	-16%	1253.1	1517.7	1852.4	2200.5
Adjuted PAT (After OI)	377.6	253.6	49%	450.8	-16%	1246	1518	1852	2201
Net Margin (%)	13.4	10.9	(140) bps	15.1	(150) bps	13.1	13.7	14.6	15.3
EPS (diluted)	15.3	13.9	10%	18.2	-15.9%	49.7	60.5	73.8	87.7
<b>EPS (Adj.)</b>	15.0	10.1	<b>48%</b>	18.0	<b>-16.5%</b>				
<b>Equity</b>	25.09	25		25		25	25.09	25.09	25.09

## Income Statement

March (Rs. in mn)	FY06	FY07	FY08E	FY09E	FY10E
<b>Net Sales</b>	<b>7765</b>	<b>9533</b>	<b>11040</b>	<b>12704</b>	<b>14397</b>
Growth (%)	11	23	16	15	13
<b>Expenses</b>	<b>6648</b>	<b>7514</b>	<b>8612</b>	<b>9884</b>	<b>11189</b>
Growth (%)	15	13	15	15	13
Raw Materials	3478	3992	4634	5329	6034
% of sales	45	42	42	42	42
Employee cost	1024	1172	1313	1483	1661
% of sales	13	12	12	12	12
Manufacturing exps	717	700	769	845	928
% of sales	9	7	7	7	6
R&D	180	145	182	254	356
% of sales	2	2	2	2	2
Selling & Dist exps	1249	1505	1715	1973	2209
% of sales	16	16	16	16	15
<b>EBIDTA</b>	<b>1117</b>	<b>2019</b>	<b>2428</b>	<b>2819</b>	<b>3209</b>
Growth (%)	-8	81	20	16	14
<b>EBIDTA %</b>	<b>14.4</b>	<b>21.2</b>	<b>22.0</b>	<b>22.2</b>	<b>22.3</b>
Other income	36	65	35	37	37
Interest	160	247	240	198	135
Depreciation	249	295	326	343	359
Misc. Exp. W/O					
<b>PBT</b>	<b>745</b>	<b>1543</b>	<b>1897</b>	<b>2315</b>	<b>2751</b>
Total Tax	145	294	379	463	550
Effective tax rate (%)	19	19	20	20	20
<b>PAT ( Before E/O items)</b>	<b>600</b>	<b>1249</b>	<b>1518</b>	<b>1852</b>	<b>2201</b>
Growth (%)	(18)	108	22	22	19
Profit from Ass.	15	4	0	0	0
Net Margin (%)	8	13	14	15	15
<b>RPAT</b>	<b>615</b>	<b>1253</b>	<b>1518</b>	<b>1852</b>	<b>2201</b>
<b>E/O items</b>	<b>-3</b>	<b>7</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Adjuted PAT</b>	<b>618</b>	<b>1246</b>	<b>1518</b>	<b>1852</b>	<b>2201</b>
Growth (%)	(13)	102	22	22	19

Source: Company, Emkay research

## Balance Sheet

March (Rs. in mn)	FY06	FY07	FY08E	FY09E	FY10E
Equity share capital	250	250	250	250	250
Share Application Money		0	0	0	0
Share Premim	267	267	267	267	267
Other Reserves	3188	4220	5415	6886	8676
<b>Networth</b>	<b>3705</b>	<b>4738</b>	<b>5933</b>	<b>7404</b>	<b>9193</b>
<b>Deferred tax liability</b>	<b>479</b>	<b>512</b>	<b>512</b>	<b>512</b>	<b>512</b>
Secured Loans	1301	1453	1253	953	653
Unsecured Loans	668	936	936	636	336
<b>Loan Funds</b>	<b>1969</b>	<b>2389</b>	<b>2189</b>	<b>1589</b>	<b>989</b>
<b>Total Liabilities</b>	<b>6153</b>	<b>7639</b>	<b>8634</b>	<b>9505</b>	<b>10695</b>
Gross Block	4546	5109	6279	6629	6929
Less: Depreciation	1099	1355	1681	2023	2383
<b>Net block</b>	<b>3447</b>	<b>3754</b>	<b>4598</b>	<b>4606</b>	<b>4546</b>
<b>Capital WIP</b>	<b>297</b>	<b>570</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Investment</b>	<b>36</b>	<b>86</b>	<b>86</b>	<b>86</b>	<b>86</b>
<b>Current Assets</b>	<b>3577</b>	<b>4657</b>	<b>5680</b>	<b>6793</b>	<b>8299</b>
Inventories	1872	2363	2709	3099	3499
Sundry debtors	1377	1807	2024	2329	2640
Cash & bank balance	55	101	560	921	1656
Loans & advances	274	386	386	445	504
Other assets	0	0	0	0	0
<b>Current liabilities</b>	<b>1205</b>	<b>1428</b>	<b>1730</b>	<b>1980</b>	<b>2237</b>
Current liabilities	1074	1250	1564	1790	2021
Provisions	131	178	166	191	216
<b>Net current assets</b>	<b>2372</b>	<b>3229</b>	<b>3950</b>	<b>4813</b>	<b>6062</b>
<b>Miscellaneous Exp</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total Assets</b>	<b>6153</b>	<b>7639</b>	<b>8634</b>	<b>9505</b>	<b>10695</b>

Source: Company, Emkay research

## Cash Flow Statement

March (Rs. in mn)	FY06	FY07	FY08E	FY09E	FY10E
Pre-tax profit	745	1543	1897	2315	2751
Depreciation	249	295	326	343	359
Chg in working cap	267	(810)	(262)	(503)	(514)
Tax paid	(87)	(237)	(379)	(463)	(550)
<b>Operating cash Inflow</b>	<b>1173</b>	<b>791</b>	<b>1582</b>	<b>1692</b>	<b>2046</b>
Capital expenditure	(759)	(874)	(600)	(350)	(300)
<b>Free Cash Flow</b>	<b>414</b>	<b>(83)</b>	<b>982</b>	<b>1342</b>	<b>1746</b>
Investments	(8)	(50)	0	0	0
Equity Capital Raised	0	0	0	0	0
Loans Taken / (Repaid)	(238)	420	(200)	(600)	(600)
Dividend (incl tax)	(157)	(217)	(323)	(381)	(411)
Others	(7)	-24	0	0	0
Increase in Msc Exp	1	0	0	0	0
<b>Net chg in cash</b>	<b>5</b>	<b>46</b>	<b>459</b>	<b>360</b>	<b>735</b>
<b>Opening cash position</b>	<b>50</b>	<b>55</b>	<b>101</b>	<b>560</b>	<b>921</b>
<b>Closing cash position</b>	<b>55</b>	<b>101</b>	<b>560</b>	<b>921</b>	<b>1656</b>

Source: Company, Emkay research

## Key Ratios (%)

March	FY06	FY07	FY08E	FY09E	FY10E
<b>Profitability (%)</b>					
EBIDTA margin	14.4	21.2	22.0	22.2	22.3
PAT margin	7.9	13.1	13.7	14.5	15.2
ROCE	14.1	24.4	25.2	26.7	27.6
ROE	17.4	29.6	28.4	27.8	26.5
<b>Per share data (Rs.)</b>					
EPS (Consolidated)	<b>24.7</b>	<b>49.7</b>	<b>60.5</b>	<b>73.9</b>	<b>87.7</b>
CEPS	34.1	61.5	73.5	87.5	102.1
BVPS	148.2	188.9	236.5	295.2	366.6
DPS (Rs)	5.7	7.4	11.0	13.0	14.0
<b>Valuations</b>					
P/E	28.3	14.1	11.6	9.5	8.0
Cash PE	20.5	11.4	9.5	8.0	6.9
P/BV	4.7	3.7	3.0	2.4	1.9
EV / Net Sales	2.4	2.1	1.8	1.5	1.3
EV / EBITDA	16.6	9.9	8.1	6.8	5.8
Dividend Yield (%)	0.8	1.1	1.6	1.9	2.0
<b>Turnover (x) Days</b>					
Debtors T/O	64.7	68.2	66.0	66.0	66.0
Inventory T/O	99.0	108.9	99.0	99.0	99.0
<b>Gearing Ratio</b>					
Net debt/ Equity (x)	0.5	0.5	0.3	0.1	-0.1
Total Debt/Equity (x)	0.5	0.5	0.4	0.2	0.1

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