IPCA Labs

Initial Opinion BUY

Equity | India | Pharmaceuticals
27 May 2010

Slated for strong growth; Initiate with Buy

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Robust growth at attractive valuation; Initiate with Buy

We initiate coverage on IPCA with a Buy rating and PO of Rs333. IPCA has lowered dependence on the anti-malarial segment and focused on diversifying its business with increased thrust on export formulations. We like IPCA for its stable domestic business, US business at inflection point and positive triggers ahead. We forecast IPCA to grow its topline by 19% CAGR over FY10-12E translating to EPS CAGR of 24%. We expect IPCA's valuation gap with peers to narrow on improved visibility of growth and diversified business mix. Our PO, pegged at 13.5x FY12E EPS, 20% discount to similar sized peers, implies 35% upside.

Formulations business to spearhead growth

We expect 19% sales CAGR over FY10-12E, driven by both, domestic (18% CAGR, 39% of sales) and export (26% CAGR, 35% of sales) formulations. Domestic formulations should sustain high growth on 30% addition to fieldforce in FY10 with thrust on high-growth chronic segments. Export formulation growth to be led by US (8% of sales by FY12E vs 3% now). API business should grow a modest 10-12% as a large part of capacity caters to captive usage.

Positive triggers provide upside potential

We expect USFDA approval for Indore SEZ in the near term (in 2HFY11) to address capacity constraint which has restricted growth in the lucrative US generics market. With 14 ANDAs (inc. 10 approvals) awaiting full scale-up and 8-10 new ANDAs to be filed p.a, US generics are forecast to grow at a 60% CAGR over FY10-12E to Rs1.5bn. Higher than expected tender supplies to WHO for Artimether-Lumefantrine (anti-malarial, ~US$250mn, 4 players) combination drug would pose upside risk.

Valuation at deep discount to peers; stock to re-rate

IPCA is trading at 12.5x FY11E & 10x FY12E, a steep 30% discount to peers which we find unjustified noting strong earnings CAGR expected over FY10-12E. Improved growth visibility and upside triggers to re-rate the stock in the near term.

Stock Data

Price	Rs243.05
Price Objective	Rs333.00
Date Established	27-May-2010
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs90.00-Rs304.40
Mrkt Val / Shares Out (mn)	US$637 / 125.1
Average Daily Volume	52,521
BofAML Ticker / Exchange	XBLAF / BSE
Bloomberg / Reuters	IPCA IN / IPCA.BO
ROE (2010E)	28.4%
Net Dbt to Eqty (Mar-2009A)	71.1%
Est. 5-Yr EPS / DPS Growth	26.0% / 15.0%
Free Float	53.8%

Estimates (Mar)

(Rs)	2008A	2009A	2010E	2011E	2012E
Net Income (Adjusted - mn)	1,357	960	2,003	2,443	3,078
EPS	10.84	8.06	16.01	19.52	24.60
EPS Change (YoY)	7.7%	-25.6%	98.7%	21.9%	26.0%
Dividend / Share	1.87	2.58	4.00	4.88	6.15
Free Cash Flow / Share	(6.39)	8.84	8.35	12.12	14.42

Valuation (Mar)

	2008A	2009A	2010E	2011E	2012E
P/E	22.43x	30.16x	15.18x	12.45x	9.88x
Dividend Yield	0.769%	1.06%	1.65%	2.01%	2.53%
EV / EBITDA*	19.62x	13.44x	11.26x	9.43x	7.78x
Free Cash Flow Yield*	-2.64%	3.64%	3.44%	4.99%	5.93%

* For full definitions of *iQmethod* SM measures, see page 22.

Refer to important disclosures on page 23 to 25. Analyst Certification on Page 21. Price Objective Basis/Risk on page 21. Link to Definitions on page 21.10942138

iQprofile SM IPCA Labs

Key Income Statement Data (Mar)	2008A	2009A	2010E	2011E	2012E
(Rs Millions)					
Sales	10,652	12,926	14,967	17,672	21,193
Gross Profit	6,014	7,854	9,095	10,738	12,875
Sell General & Admin Expense	(3,845)	(4,714)	(5,371)	(6,253)	(7,449)
Operating Profit	1,492	2,256	2,722	3,277	4,037
Net Interest & Other Income	260	(1,073)	(231)	(218)	(195)
Associates	NA	NA	NA	NA	NA
Pretax Income	1,753	1,183	2,491	3,059	3,842
Tax (expense) / Benefit	(360)	(280)	(550)	(684)	(835)
Net Income (Adjusted)	1,357	960	2,003	2,443	3,078
Average Fully Diluted Shares Outstanding	125	125	125	125	125
Key Cash Flow Statement Data					
Net Income	1,357	960	2,003	2,443	3,078
Depreciation & Amortization	325	397	445	505	547
Change in Working Capital	(1,259)	(736)	(889)	(992)	(1,512)
Deferred Taxation Charge	62	78	89	102	105
Other Adjustments, Net	101	1,276	727	807	937
Cash Flow from Operations	585	1,974	2,375	2,866	3,155
Capital Expenditure	(1,387)	(869)	(1,331)	(1,350)	(1,350)
(Acquisition) / Disposal of Investments	NA	NA	NA	NA	NA
Other Cash Inflow / (Outflow)	(9)	(316)	158	143	5
Cash Flow from Investing	(1,396)	(1,185)	(1,173)	(1,207)	(1,345)
Shares Issue / (Repurchase)	1	(1)	0	0	0
Cost of Dividends Paid	(235)	(323)	(501)	(611)	(769)
Cash Flow from Financing	804	(769)	(990)	(1,599)	(1,733)
Free Cash Flow	(801)	1,105	1,044	1,516	1,805
Net Debt	3,436	4,486	4,504	4,291	4,210
Change in Net Debt	1,147	1,050	18	(213)	(81)
Key Balance Sheet Data					
Property, Plant & Equipment	4,143	5,768	6,623	7,467	8,270
Other Non-Current Assets	1,371	556	429	286	281
Trade Receivables	2,676	3,391	3,747	4,425	5,308
Cash & Equivalents	94	113	326	385	462
Other Current Assets	3,318	3,893	4,480	5,194	6,231
Total Assets	11,602	13,722	15,604	17,757	20,551
Long-Term Debt	3,530	4,599	4,829	4,675	4,671
Other Non-Current Liabilities	574	651	749	824	906
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	1,607	2,162	2,214	2,615	3,023
Total Liabilities	5,710	7,412	7,793	8,114	8,600
Total Equity	5,892	6,309	7,811	9,643	11,951
Total Equity & Liabilities	11,602	13,722	15,604	17,757	20,551
iQmethod* SM - Bus Performance					
Return On Capital Employed	13.4%	16.0%	17.0%	17.8%	19.3%
Return On Equity	25.5%	15.7%	28.4%	28.0%	28.5%
Operating Margin	14.2%	17.6%	18.3%	18.7%	19.2%
EBITDA Margin	17.1%	20.5%	21.2%	21.4%	21.6%
iQmethod* SM - Quality of Earnings					
Cash Realization Ratio	0.4x	2.1x	1.2x	1.2x	1.0x
Asset Replacement Ratio	4.3x	2.2x	3.0x	2.7x	2.5x
Tax Rate (Reported)	20.5%	23.7%	22.1%	22.4%	21.7%
Net Debt-to-Equity Ratio	58.3%	71.1%	57.7%	44.5%	35.2%
Interest Cover	6.2x	6.0x	8.9x	10.6x	13.3x
Key Metrics					

* For full definitions of *iQmethod* SM measures, see page 22.

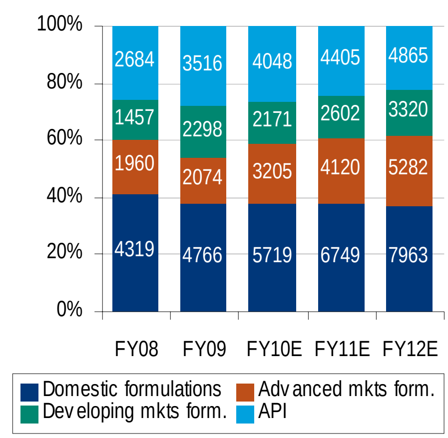
Company Description

Mumbai based IPCA Labs is a fully integrated pharmaceuticals company with a diversified revenue mix (53% exports). With a product portfolio of 150+ formulations across therapies, IPCA is a leader in anti-malarials and Rheumatoid-Arthristis segmenst in the domestic market. Leveraging its strength in API, IPCA has been succesful in its export formulations strategy, with recent entry into the lucrative US generic market.

Investment Thesis

We are positive on IPCA's steady growth prospects, given export formulations poised for a stronger growth trajectory. We expect robust 24% EPS growth over the next two years driven by 19% revenue growth. Focus on chronic segments, strong backward integration and rich product pipeline would be key growth drivers. Given the stocks significant discount to sector average, we view IPCA as an attractive value play and expect valuations to move close to the sector average over the next 12 months.

Chart 1: IPCA – Business mix (Value in Rsmn)

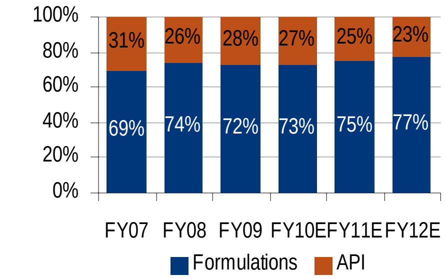


Source: Company, BofA Merrill Lynch Global Research

Stock Data

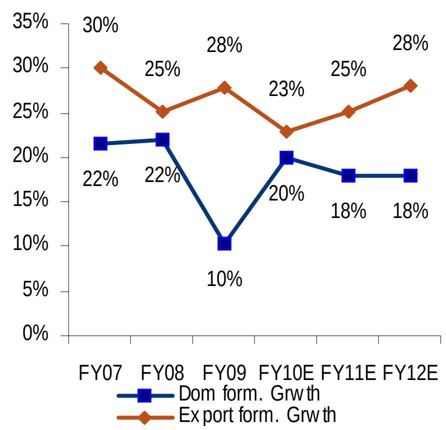
Price to Book Value	3.9x

Chart 2: Increasing share of formulations



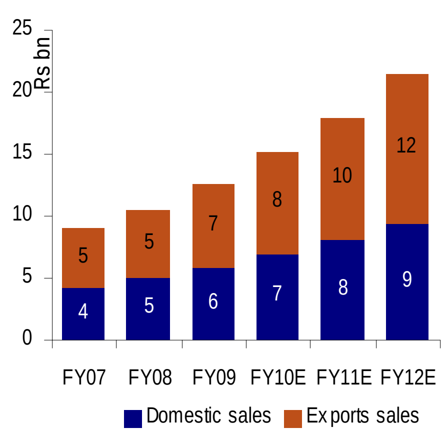
Source: Company, BofA Merrill Lynch Global Research

Chart 3: Export formulations scaling up



Source: Company, BofA Merrill Lynch Global Research

Chart 4: Forecast sales growth of 19%



Source: Company, BofA Merrill Lynch Global Research

Initiate with Buy; PO of Rs333/sh

We initiate coverage on IPCA with a Buy rating and PO of Rs333. IPCA is one of India's emerging pharmaceuticals companies, with over 73% of its revenues derived from formulations. Strong backward integration is one of the key strengths of IPCA with most products backed by in-house API (Active Pharmaceutical Ingredient). Exports form 55% of revenues, of which 27% are accounted by branded formulations (grew by 31% over FY06-09). IPCA's recent entry into developed generics market (39% of exports) has met with reasonable success and further scale-up, especially in the US market through new launches would ensure robust growth outlook.

We forecast a 19% CAGR in revenues translating to 24% net profit CAGR over FY10-12E, with sustained new launches aided by strengthening of API capabilities. The stock trades at a 30% discount to its domestic peers, despite stronger growth rates and we believe a re-rating is justified on enhanced scale and diversification of its operations.

Strong footing in domestic formulations

IPCA's domestic formulations business accounts for 38% of total revenues, having grown at a 5-yr CAGR of 23% over FY06-09. IPCA has consistently outperformed industry growth rates (10-12%) and much of the growth can be attributed to the thrust on chronic therapy segments. We expect IPCA to sustain above industry growth rates and forecast an 18% CAGR in domestic formulations to be driven by 18-20 new launches and 1000+ field force additions to help focused marketing.

Scaling up export formulations

With increased focus on the export formulations business across markets, IPCA is poised to register strong 26% CAGR over FY10-12E. While new launches and increased geographical coverage would support growth in developing markets, likely approval of USFDA facility (Indore SEZ) would fuel scale-up of generic formulations. Export formulations account for 35% of total sales for IPCA.

Vertical integration aids competitiveness

IPCA's strength in formulations business can be largely attributed to the API capabilities the company has built up over time. Not only does it help in creating a strong new product pipeline, it also ensures that IPCA remains cost-competitive in key geographies, especially generic markets where price erosion can be severe. While most of the products in generic markets have in-house API sourcing, developing markets also benefit from the company's experience in the domestic formulations market.

Stock triggers ahead

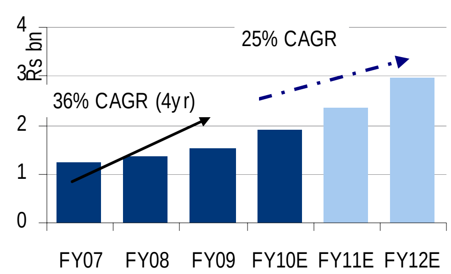
Tender win may provide positive surprise

IPCA has received WHO pre-qualification for supplies of Artimether+Lumefantrine formulation (anti-malarial, ~US$250mn). IPCA is among the four enlisted companies and the only one to be fully integrated for the product, thereby standing high chances of winning the tender. We expect news flow on the WHO tender before the onset of malaria season (by Sept-10). Higher than expected market share for this lucrative product may provide upside risk (we estimate ~5% mkt share for IPCA in FY11E).

USFDA approval for Indore SEZ- upside trigger

IPCA's Indore facility is ready for commissioning and is awaiting USFDA approval to commence supplies to the US generic market. IPCA has already filed 2 ANDAs (Abbreviated New Drug Application) from this facility and we expect an approval for the same in 2HFY11. Indore facility approval would not only help commercialise already approved ANDAs, but also improve profitability as the company is incurring fixed expenses before commencing US shipments. Indore facility has peak revenue potential of Rs3.5bn and an earlier than expected approval may provide an upside trigger for the stock.

Chart 5: Robust earnings growth trajectory



Source: Company, BofA Merrill Lynch Global Research

Forecast 24% earnings growth over FY10-12E

Over FY10-12E, we expect IPCA to register 24% profit CAGR. This will be mainly driven by annual sales growth of 19%, on expanding presence in existing markets, as well as scale up in US generics market, aided by robust product filings and focused marketing. We also expect margins to move up slightly, on better sales mix (i.e. formulations) and operating leverage.

Re-rating expected on strong growth outlook

IPCA trades at 1-year forward multiples of 10.5x P/E (FY12E), a steep discount to domestic and global peers, albeit at the higher end of historical averages. However, we believe that IPCA's strong and sustainable growth rates (19% sales, 24% EPS CAGR over FY10-12E) as well as diversified business mix with increased exposure to generic markets should drive valuation multiples closer to peers. Our target multiple of 13.5x is pegged at FY12E earnings, still at ~20% discount to sector average which is justified.

Comparable Valuations

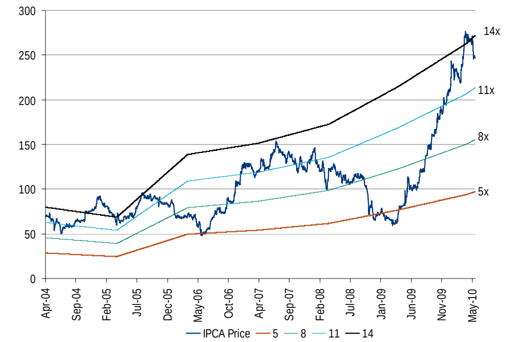
Table 1: Indian Pharma coverage valuation comparables

		CMP	Mkt Cap	P/E (x)			EPS CAGR	EV/EBITDA (x)			RoE (%)			EV/Sales (x)		
Stock	QRQ	Rs	US$mn	FY10E	FY11E	FY12E	10-12E	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E
Dr Reddys	Underperform	1262	4,632	25.6x	21.5x	17.4x	21%	18.2x	15.6x	12.8x	23%	25%	24%	3.4x	3.0x	2.5x
Lupin	Buy	1808	3,497	23.6x	19.0x	14.6x	27%	17.1x	13.8x	10.8x	37%	32%	32%	3.5x	2.8x	2.3x
Cadila	Buy	605	2,692	24.3x	19.5x	14.6x	29%	16.3x	13.6x	10.8x	36%	33%	34%	3.7x	3.1x	2.5x
Divi's	Buy	697	2,003	27.1x	21.7x	16.2x	29%	20.9x	16.4x	12.5x	25%	25%	27%	9.5x	7.3x	5.6x
Glenmark*	Buy	264	1,550	19.1x	14.3x	10.6x	34%	12.9x	9.1x	7.9x	9%	12%	18%	3.6x	2.9x	2.3x
Biocon	Buy	281	1,223	19.2x	15.0x	12.5x	24%	11.7x	9.7x	8.2x	18%	19%	20%	2.6x	2.2x	1.9x
GSK Pharma^	Underperform	2009	3,699	28.3x	25.0x	21.6x	15%	22.1x	18.9x	16.4x	28%	29%	29%	7.9x	6.7x	5.9x
IPCA*	Buy	243	662	16.3x	13.2x	10.5x	25%	11.7x	9.7x	8.1x	27%	27%	28%	2.5x	2.1x	1.7x
India Pharma sector average				23.2x	18.5x	14.3x	28%	16.2x	13.0x	10.5x	24%	25%	26%	4.4x	3.5x	2.9x

Source: BofA Merrill Lynch Global Research. *FY10 estimates, all others are actuals; ^ - Dec- ending; Average excludes IPCA Labs, Glaxo Pharma

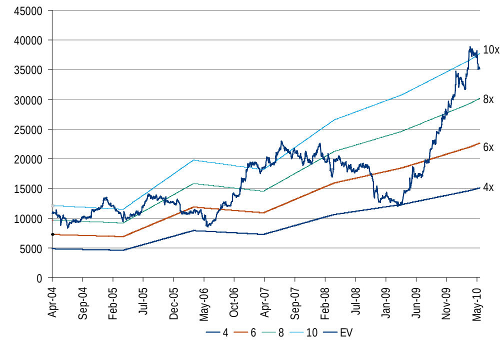
Valuation bands

Chart 6: IPCA – 1 year forward P/E bands



Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 7: IPCA – 1 year forward EV/EBITDA bands



Source: Bloomberg, BofA Merrill Lynch Global Research

Key risks/concerns

- Any delays in regulatory process with USFDA, THA, etc and other regulatory authorities may affect new launches and hence, growth outlook.
- Delay in USFDA approval for Indore SEZ may lead to lower profitability and loss of sales as the plant is ready for commissioning and is incurring fixed expenses. We have factored Rs750mn revenues from Indore facility in FY12E
- IPCA derives over 52% of its revenues from exports to different countries. A sharp appreciation/depreciation of rupee may have an adverse/favorable impact on realisations, hence profitability. The company has however, largely hedged itself from forex fluctuations through effective forward hedges.

Bull & bear case

	Bull case	Bear case	BofA-Merrill Lynch view
US generics	■ Indore SEZ approval by 3QFY11 to help commercialise already approved ANDAs ■ Expect 5% base business price erosion ■ Earlier than expected USFDA approvals for new filings can improve visibility	■ Delays in Indore SEZ approval to affect scale-up of US generics business ■ Higher than 10% base business price erosion ■ Delays in USFDA approval process, higher competition may lead to lower-than-expected growth from new launches	■ Forecast 10% base business price erosion, expect 3-4 new product launches p.a. We expect IPCA to file 8-10 new ANDAs every year, most backed by own APIs ■ We expect US generics to account for 8% of total revenues by FY12E (60% CAGR)
India formulations	■ Focus on chronic segments would help outpace industry growth ■ Further improvement in field force productivity to lead to higher profitability	■ Threat of increased DPCO coverage to affect portfolio growth and profitability ■ Fewer new launches to affect growth outlook	■ We believe IPCA would continue to grow ahead of the IPM (~18% vs 10-12% for IPM). Chronic therapy focus to lead to higher growth and profitability ■ We expect 18-20 new launches to sustain growth momentum
RoW	■ Strong product pipeline and expansion to newer markets to help growth acceleration	■ Currency fluctuation, worsened working capital could impose further stress on profitability	■ We forecast 24% sales CAGR over FY10-12E in RoW front, driven by product filings, and field force expansion. ■ Working capital requirements to increase initially, but improve on business scale up
Tender business	■ Higher than 20% market share in WHO tender for Artimether-Lumefantrine (anti-malarial drug, ~US$250mn) can provide material upside to forecasts.	■ Lack of tender wins can lead to downside risk in our estimates	■ We expect IPCA to get 5-10% market share in this product's tender, which is reasonable considering there are only 5 players and IPCA is the only fully vertically integrated player.

Source: BofA Merrill Lynch Global Research

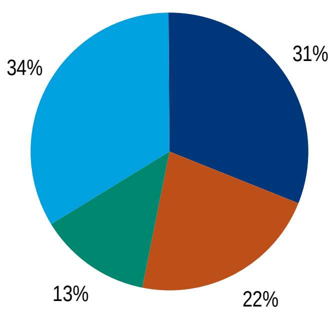
Business Overview

Based in Mumbai, IPCA Labs is a fully integrated pharmaceutical company with strong capabilities in manufacturing and marketing of formulations (branded as well as generic), API's and intermediates. With 10 manufacturing facilities spread across India having regulatory approval from most regulators (USFDA, UKMHRA, TGA, WHO, MCC-SA, etc), IPCA exports its products to over 110 countries.

In the past 5 years, the company has been diversifying its revenue base with increased thrust on formulations with 73% of revenues (vs 66% in FY05) coming from the segment. We expect share of formulations in total turnover to increase to 77% by FY12E given stronger growth in the segment.

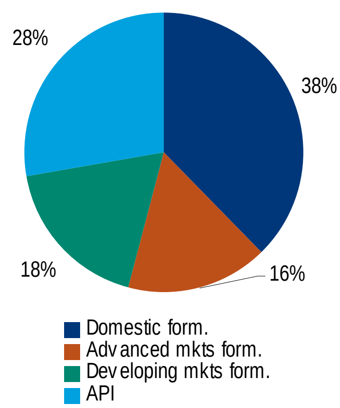
IPCA's business mix has shown increased emphasis on export formulations. Going forward, we expect advanced markets formulations exports to be the key growth driver, rising from 16% of sales in FY09 to 25% in FY12E.

Chart 8: IPCA- business mix in FY05



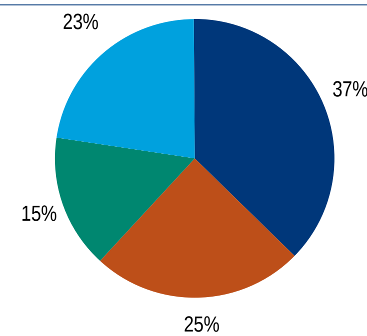
Source: BofA Merrill Lynch Global Research, Company

Chart 9: IPCA- business mix in FY09



Source: BofA Merrill Lynch Global Research, Company

Chart 10: IPCA- business mix in FY12E



Source: BofA Merrill Lynch Global Research, Company

Diversifying Revenue mix over time

Table 2: IPCA - Revenue split

Rs (in millions)	FY08	FY09	FY10E	FY11E	FY12E
Formulations	7736	9138	11095	13471	16566
Domestic	4319	4766	5719	6749	7963
Exports	3417	4372	5376	6723	8602
Total advanced markets	*1960*	*2074*	*3205*	*4120*	*5282*
Total developing markets	*1457*	*2298*	*2171*	*2602*	*3320*
API	2684	3516	4048	4405	4865
Domestic	741	1083	1213	1274	1338
Exports	1943	2432	2834	3131	3527
Total advanced markets	*1243*	*1528*	*1760*	*1917*	*2128*
Total developing markets	*699*	*904*	*1074*	*1214*	*1399*
Total Sales	10419	12653	15142	17876	21431

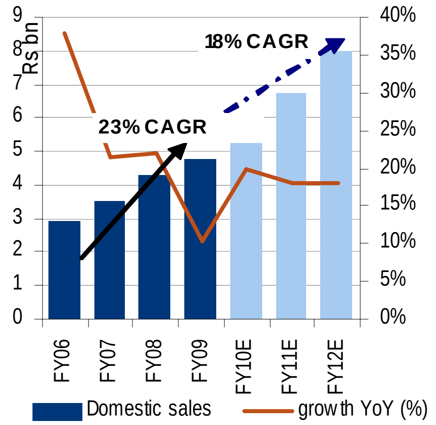
Source: BofA Merrill Lynch Global Research, Company

Table 3: IPCA - Revenue split (as % of total sales)

	FY08	FY09	FY10E	FY11E	FY12E
Formulations	74%	72%	73%	75%	77%
Domestic	41%	38%	38%	38%	37%
Exports	33%	35%	36%	38%	40%
Total advanced markets	*19%*	*16%*	*21%*	*23%*	*25%*
Total developing markets	*14%*	*18%*	*14%*	*15%*	*15%*
API	26%	28%	27%	25%	23%
Domestic	7%	9%	8%	7%	6%
Exports	19%	19%	19%	18%	16%
Total advanced markets	*12%*	*12%*	*12%*	*11%*	*10%*
Total developing markets	*7%*	*7%*	*7%*	*7%*	*7%*
Total Sales	100%	100%	100%	100%	100%

Source: BofA Merrill Lynch Global Research, Company

Chart 11: Domestic formulations growth



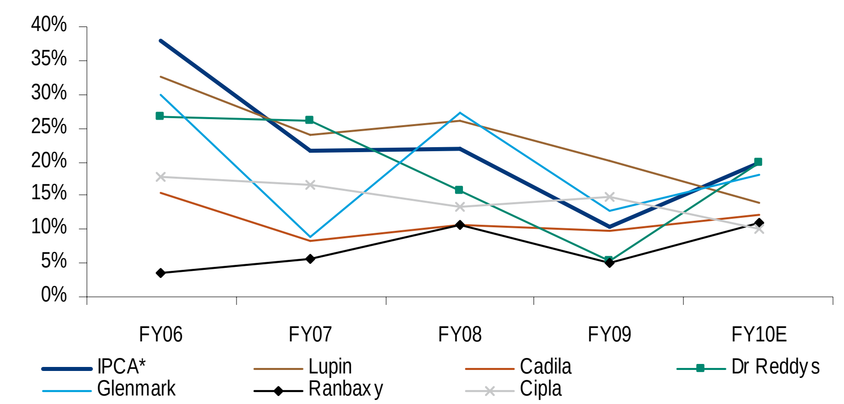
Source: Company, BofA Merrill Lynch Global Research

Domestic formulations on strong footing

IPCA has strengthened its position in the fragmented Indian Pharma market (IPM) (worth ~US$9bn) by consistently focusing on high-growth chronic therapy segments and increased penetration through strong fieldforce. Rising healthcare awareness, increasing penetration to semi-urban and rural areas and growing lifestyle disease would help IPM to sustain 12-14% growth over medium term. Domestic formulations business accounts for 38% of total revenues for IPCA, having grown at a 5-yr CAGR of 23% over FY06-09, well above the industry average of 12-14%.

IPCA's strategy in the domestic market has been to enhance its portfolio, leveraging on its strength in the API segment and promoting the brands through a strong fieldforce. More than 60% of domestic formulation sales are attributed to high growth segments like cardiovascular, neurology, diabetology, etc. IPCA's dependency on anti-malarials and other acute therapy segments has reduced over time and we expect increased chronic therapy focus would be a key growth driver for domestic formulations.

Chart 12: IPCA: Consistently growing above industry average

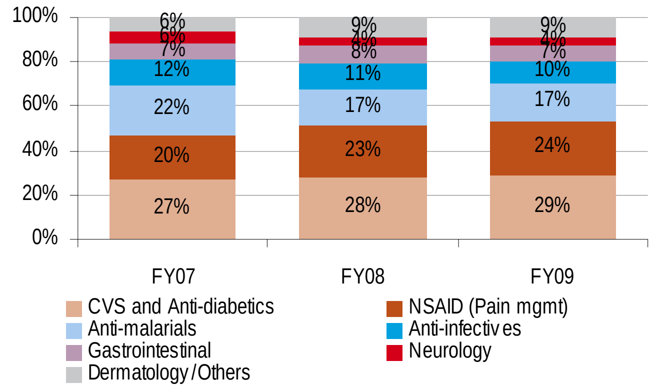


Source: Company, BofA Merrill Lynch Global Research

Chronic segments account for 60%+ of the portfolio

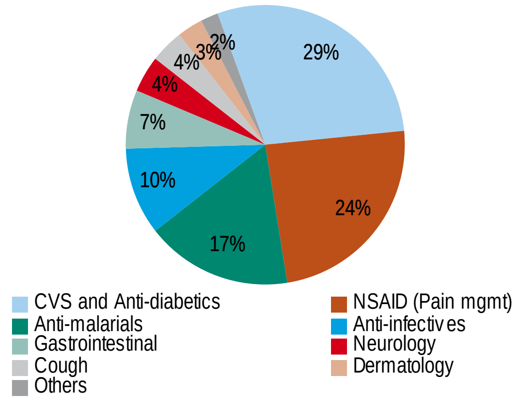
IPCA is ranked 27th in the Indian Pharmaceuticals Market (IPM) as per ORG-IMS with a market share of 1.4%. It has 130 brands in the market launched under 8 marketing divisions backed by a strong sales force of ~3000 currently (vs 2300 in FY09). IPCA is the market leader in the anti-malarial (40%+ mkt share) and rheumatoid arthritis (50%+ mkt share) segments. Only 11% of IPCA's sales are derived from products under DPCO (Drug Price Control Order) coverage (largely Lariago). We expect IPCA to sustain above industry growth rates and grow its domestic formulations at a CAGR of 18% over FY10-12E.

Chart 13: IPCA - Increased thrust on chronic segments



Source: Company, ORG-IMS Health

Chart 14: IPCA – Domestic formulations therapy split (FY09)



Source: Company, ORG-IMS Health

Key drivers for sustaining growth in this market are:

- **Strengthen fieldforce** by adding ~1,000 medical representatives over FY11-12E to increase reach and penetration. Currently IPCA's sales force reaches out to ~200,000 doctors (~27% penetration) compared to total 750,000+ doctors in the country. We expect fieldforce additions to enable focused marketing efforts on new launches with improved doctor coverage. IPCA has added over 2,000 fieldforce (of total 3,000) in the last four years. Increasing productivity from the fieldforce would contribute to improving profitability.

- **Add new marketing divisions** to broad base its product portfolio further and enable focused marketing of products. IPCA would add three more divisions (one each in Cardiac, Neurology and Nephrology segment) in FY11 to supplement its growth plans. This would further increase sales in the high-growth chronic segments. We believe IPCA would continue to strengthen its marketing efforts by adding new divisions as well as adding in-licensed products. We expect share of chronic segments to improve from 60% currently to 65% over the next two years.

- **IPCA derives ~21% growth from products launched in the last 5 years**. We expect the company to launch 12-15 new products every year, with an effort to increase the size of existing brands as well.

Table 4: IPCA - Domestic formulations fieldforce split

Division Name	Target segment	Sales force
Existing divisions		
Pharma	Physicians & General Practitioners	825
Intima	Anti-malarials	550
3C	Cardiovascular	450
Hi-Care	Cardiovascular	200
Bionova	Dermatology	180
Activa	Pain management	350
Altus	Surgeons	300
New divisions		
3 D	Cardiovascular	to be added
Neurosciences	Neurology	100
Nephrosciences	Nephrology	100

Source: Company, as on March 2010

Table 5: New products drive domestic sales

	% contribution	Sales (Rsmn)
launched in FY05	10%	485
launched in FY06	3%	155
launched in FY07	1%	59
launched in FY08	6%	260
launched in FY09	1%	25
Total new products	21%	984
Products launched prior to FY05	79%	3676
Grand total	100%	4660

Source: Company, FY09

- Strong brand-building efforts to increase market share of recently launched brands through CRM activities and raising awareness among physicians. Currently, three of IPCA's brands feature in the top 300 brands in the IPM (namely HCQS, Lariago and Raptiher)

Sustainable growth with high margin profile

IPCA is well placed to derive sustainable growth in the branded formulations segment with higher than company average profits. We expect this segment to have EBITDA margins of 26-27%, well above the company average of 21%. Moreover, we expect margins to improve gradually as fieldforce added in recent times start contributing to profit (1 year since inclusion). With higher contribution of chronic therapy products in the portfolio, the profitability is likely to improve.

Export formulations scaling up

With increased focus on export formulations business across markets, IPCA is poised to register strong 27% CAGR over FY10-12E. IPCA exports to over 110 geographies with direct field force presence in 43 countries in CIS, South East Asia, Middle East, Africa and Latin America. Export formulations account for 35% of total business, of which 15% is accounted for by developing nations (branded formulations). IPCA is ramping up its presence in the generics markets (developing nations) with recent entry into the US market (Sept-08).

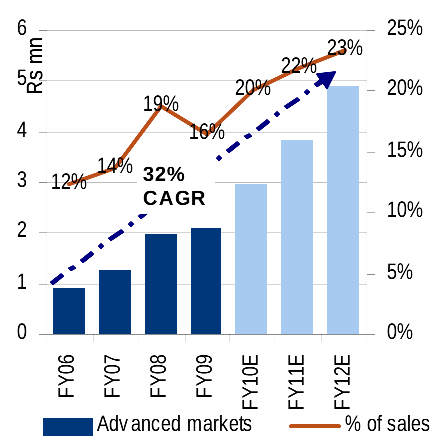
We expect export formulations to comprise 39% of total revenues by FY12E driven by ramp up in US and new launches across markets. IPCA's export portfolio includes cardiovascular, NSAIDs, anti-diabetics and anti-malarial formulations of which cardiovascular and anti-diabetic products constitute 39% of sales. Institutional business (hospitals and WHO, Unicef) would also be a growth driver going forward with the company's accreditation and past track record.

Table 6: International generics: Product filing status

Region	Registered	Under registrations	Under development
EU/UK	36	19	31
Australia/NZ	21	10	3
South Africa	35	15	0
US	10	4	24

Source: Company

Chart 15: Advanced markets formulations grwth



Source: Company, BofA Merrill Lynch Global Research

Advanced markets ramp up led by US generics

IPCA derives 20% of its business from exports to developing markets like US, UK, Australia (generic markets). These markets constitute 57% of total export formulations and have reported growth of 31% over the last 4 years (FY06-09). IPCA is a recent entrant in the US market and has already launched 9 products through partnerships. UK is IPCA's largest generic market as of now and ~14% of total revenues are derived from this geography. IPCA has a strong pipeline of 19 dossiers pending registrations (36 registered) that should ensure a healthy growth of 19% in EU market over next two years. For the US market, IPCA would adopt partnership route wherein IPCA would develop, register and manufacture the product, to be distributed by partners for profit share.

Tie-up with Ranbaxy for US markets

Currently IPCA has a marketing agreement with Ranbaxy for 25 ANDAs of which 15 have been filed, and 10 approved and 6 launched in the market. IPCA has been able to garner a market share of 5-20% for these products. The agreement provides for normal profits on API as well as for regulatory expenses incurred with the remaining profit contribution being shared by Ranbaxy and IPCA equally. Currently, only the Silvassa facility is approved for formulations by the USFDA which has kept the scale-up in control. However, with expected approval of Indore facility, we expect monetization of approved pipeline in a larger scale.

USFDA approval for Indore facility to boost outlook

IPCA's Indore manufacturing facility is complete and awaiting USFDA approval in order to cater to increasing demand from the US market. IPCA intends to file 10-12 ANDAs every year to build up a strong pipeline. **Interestingly, all the US ANDA applications are fully integrated ensuring price competitiveness in the US market.** The company is currently working on 28 products, which would be filed in the course of next 3-4 years.

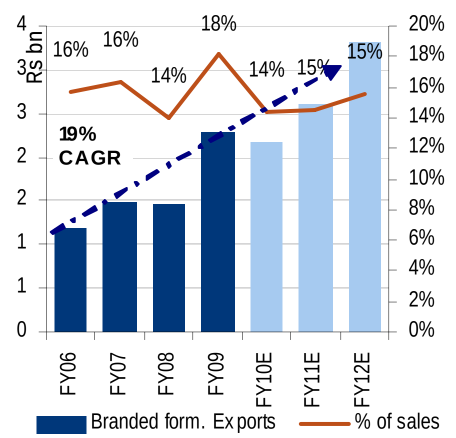
We expect the US generics business for IPCA to grow at 60% every year on the back of low base and ramping up of operations. We are assuming USFDA approval for Indore facility in December 2010. An earlier approval may provide upside risk to our estimates. Indore SEZ has a peak revenue potential of Rs3.5bn, sufficient to cater to IPCA's planned growth over the next 3 years. We expect share of US generics in total sales to grow from 2% in FY09 to 8% by FY12E.

Table 7: International generics: Product filing status

Region	Registered	Under registrations	Under development
EU/UK	36	19	31
Australia/NZ	21	10	3
South Africa	35	15	0
US	10	4	24

Source: Company

Chart 16: Branded form. Exports on robust path



Source: Company, BofA Merrill Lynch Global Research

Branded formulations to benefit from strong pipeline

IPCA has strong presence in branded formulations markets thanks to its expertise in API and presence in over 40 countries. IPCA would leverage its capabilities in Cardiovascular, Anti-diabetics, NSAIDS and anti-bacterial segments to expand reach to newer developing markets.

Developing nations account for 43% of export formulations turnover for IPCA. CIS, Middle-East and Africa are IPCA's stronghold with steady regulatory filings and focused promotion ensuring a historical growth of 25% in the branded formulations export. With a steady pipeline of products from the domestic market as well as increased presence in Latam and other markets (western African countries); we believe IPCA would be able to grow by 24% every year in the developing markets. With about 50 products planned for registrations across different markets, we believe IPCA is well placed to benefit from its experience and success in the domestic formulations market (with similar characteristics).

While last fiscal (FY10) was affected by global turmoil as well as currency fluctuations, we expect stabilization of economies would help strong bounce back in these markets. We forecast a strong 24% CAGR over FY10-12E in these markets driven by a recovery in key markets and lower base of FY10.

Upside from Artemether-Lumefantrine to boost revenues

IPCA has WHO pre-qualification for Artemether-Lumefantrine formulations (anti-malarial, ~US$250mn). We expect IPCA to generate revenues of US$10mn (3% of total sales) and US$25mn (5% of total sales) in FY11E and FY12E from tender supplies of this anti-malarial combination drug to WHO and other agencies. This is a lucrative product opportunity with higher than company average margins, thus helping margin expansion.

IPCA well placed to get 5-10% market share for this tender business

Apart from IPCA, there are only 3 other players Novartis, Cipla and Ajanta Pharma on the WHO approved list who are eligible to participate in tenders. Each tender for the product is worth US$5-10mn. Novartis currently has the largest share in the institutional tender business for the product. But unlike Novartis which sources API from third-party, IPCA is the only company in the world to have full backward integration for both Artemether and Lumefantrine (own API) as well as WHO pre-qualification.

As such, we believe IPCA is well positioned to win tenders given its pricing advantage with backward integration. The combination drug is used for ~200mn treatments every year with average cost of US$1.3 per treatment. We expect IPCA to be able to get at least 5% market share in the first year (FY11), increasing it to 10% in FY12E. We believe that higher than expected wins in tender business can provide upside risk to our estimates.

API business benefits from global relationships

IPCA has had a solid position in API business where it has forged relationships with MNC firms for overseas markets as well as supplies to domestic companies across therapy areas. With a robust pipeline of 52 DMFs (covering 65 API products), IPCA intends to strengthen its product offering by filing one DMF every month (12 p.a) going forward and have a portfolio of 100 API products by FY12E.

Strong API capabilities aids vertical integration

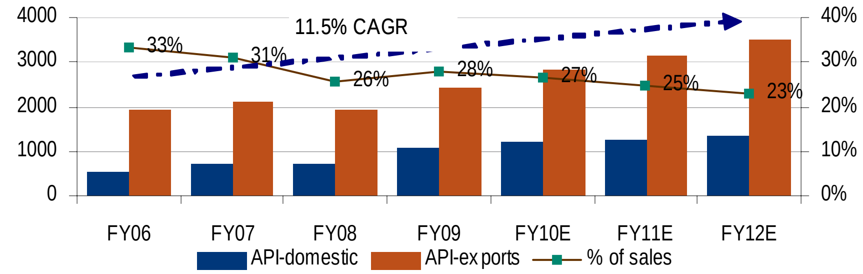
Cost leadership in API segment through lean management and resource optimisation is one of key success factors for IPCA. IPCA has 18 API facilities spread across the country to cater to needs of external customers as well as captive use. IPCA is one of the largest suppliers as well as the cost leader for at least 10 API products including Atenolol, Chloroquine Phosphate, Furoseminde and Pyrantel. Increasingly IPCA is adding products in the chronic therapeutic segments as it strengthens its capabilities. India and Europe are the largest market for API sales (comprising over 40% of API sales).

API business for IPCA constitutes 28% of total sales, growing at 12% over last 4 years on the back of steady demand from local players. With increased impetus on API sourcing from India by MNC companies, we expect API business to sustain 10% CAGR for FY10-12E.

Share of API in total revenues to reduce

We expect share of API in total revenues to come down from 27% in FY10E to 22% in FY12E given stronger growth outlook for formulations business. The company's strength in the API segment has enabled it to introduce products in domestic and international markets with high degree of backward integration, ensuring competitive pricing. However changing mix would help margin expansion over medium term.

Chart 17: Lower share of API in total revenues



Source: Company, BofA Merrill Lynch Global Research

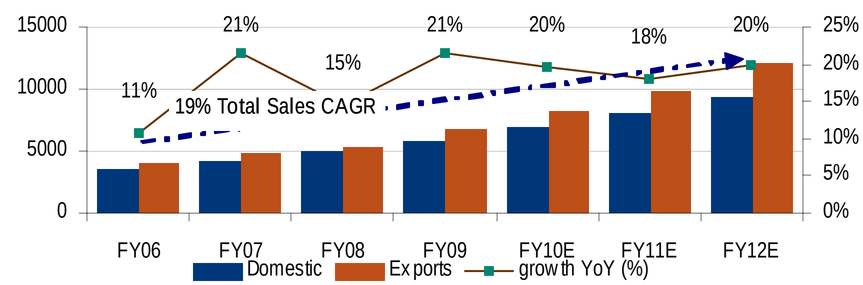
Earnings outlook

Over FY10-12E, we expect IPCA to register a 24% CAGR in profits. We expect IPCA to sustain its strong earnings momentum over FY10-12E driven by robust topline growth of 19% and margin gains through improved business mix. We expect depreciation provisioning to continue to increase in line with the capex cycle, but interest outgo to be restricted, thanks to improving scale of operations helping debt repayment over time.

Forecast revenue growth of 19%

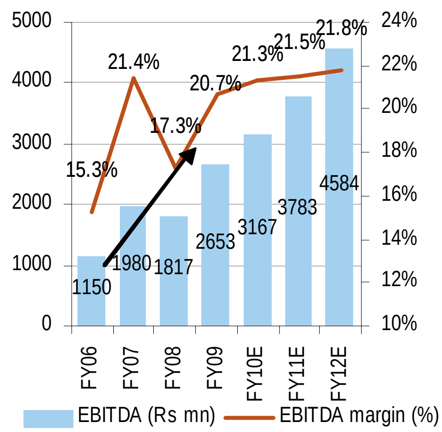
We expect IPCA's revenue growth to remain strong at 19% over FY10-12E driven by multiple drivers like (a) domestic formulations growing at 18% (above industry average of 12-14%), (b) revival in export branded formulations business and (c) ramp up in generic formulations (exports) led by expected US facility approval. New launches led by higher product filings are going to be key drivers for growth apart from entering newer markets. USFDA approval for Indore SEZ to help ramp up US generic exports, with 10 approvals already in place and more ANDA filings being added. We expect share of API in total revenues to reduce from 27% currently to 22% by FY12E on the back of stronger growth in formulations business.

Chart 18: IPCA – Forecast sustained Sales CAGR of 19% over FY10-12E



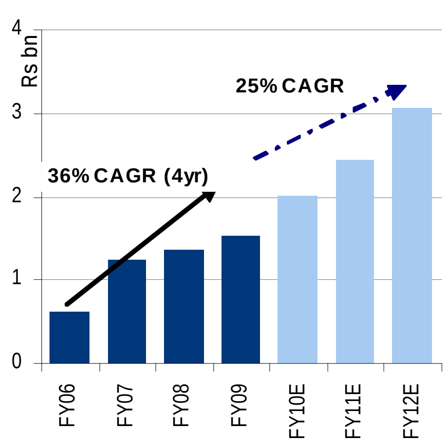
Source: Company, BofA Merrill Lynch Global Research

Chart 19: Forecast EBITDA CAGR of 20% (2 yr)



Source: Company, BofA Merrill Lynch Global Research

Chart 20: Forecast 25% Net profit CAGR



Source: Company, BofA Merrill Lynch Global Research

Margins to expand on improving mix

IPCA has been able to expand its EBITDA margins from 17.3% in FY08 to 20.7% in FY09, thanks to increased share of the formulations business. We expect IPCA to sustain EBITDA margins in the range of 21-22% over FY10-12E with gradual margin improvement every year. We forecast EBITDA to grow at 20% CAGR over FY10-12E driven by cumulative 50bps margin expansion.

Higher export formulations to drive margins

This is likely on account of improving product mix in favor of high margin export formulations. Moreover, the company would gain from operating leverage arising from commencement of US supplies from Indore SEZ, currently unutilized for commercial production. We forecast 20% CAGR in EBITDA over FY10-12E driven by 50bps cumulative EBITDA margin expansion. IPCA has tried to evolve its business model in such a way that it can capture the entire value chain around a product. Apart from this, conservative management approach towards overheads and stringent cost control measures have kept margins under control.

Rupee appreciation impact in margins already factored

While rupee appreciation is likely to have adverse impact on realizations, improving product mix would help prevent margin erosion to a large extent. With a large part of currency appreciation behind us, we do not foresee EBITDA margins dipping below 21% in the medium term. The company has hedged 60% of its forward sales over next 18 months at Rs46-48 levels (mostly in plain vanilla contracts) thereby ensuring most of the net exposure to forex is covered (with 18-20% costs incurred in foreign currency).

US generics, Domestic formulations most profitable

In terms of market-wise margins, we believe US Generics offer the highest margins for the company given strong backward linkage while EU profitability is lower than the company average. Branded formulations (both domestic and exports) generate above company average margins.

Forecast 24% net profit CAGR over FY10-12E

We expect IPCA's net profit to grow faster than EBITDA CAGR of 20% due to favorable operating leverage. This is despite our forecast of higher tax rates following MAT rate increase (from 15% to 18%). Robust topline growth of 19% with sustained EBITDA margins of ~21% would aid net profit CAGR of 24% over FY10-12E.

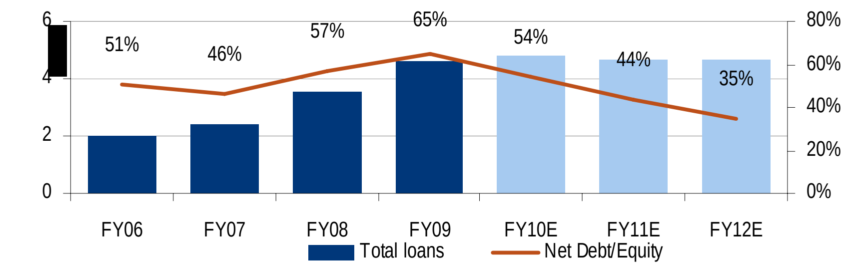
Capex plan to support future growth

IPCA has added an average capex of Rs1bn every year for the past three years to support its organic growth activities. A large part of the capex has been spent on the Indore SEZ facility (Rs1bn). We expect IPCA to incur capex of Rs1.6-1.7bn every year over FY10-12E which would be deployed towards the Sikkim facility, upgrading existing facilities with high-end machines to boost productivity and for maintenance capex. The Sikkim facility is entitled to 100% tax and excise benefit for 10 years and is expected to be operational in FY11. The Sikkim facility will cater to domestic formulations, freeing Dehradun plant's capacity for exports. We expect the capex to be funded through internal accruals. We do not factor any inorganic expansion in our estimates.

Comfortably placed on gearing/liquidity

IPCA's net debt equity ratio is hardly 65%, fairly comfortable for a company of its size given strong growth prospects. We expect IPCA outstanding debt to be maintained at current levels of ~Rs4.5bn (mostly short-term). We estimate gearing to decline further to 35% by end-FY12E, aided by strong profitability and efficient working capital management. Interest coverage will continue to remain comfortable (~7x). The company has been prudent in controlling its working capital days to less than six months (inventory and debtors) resulting in net working capital days of ~70 days.

Chart 21: Leverage to reduce on improving profitability



Source: Company, BofA Merrill Lynch Global Research

Return ratios to improve

We believe IPCA's RoE and ROCE to improve gradually on the back of robust profit growth and improving free cash flows. We expect RoCE of 20% in FY10E and 22% in FY11E while RoE is expected to inch up marginally from 27% in FY10E to 28% in FY11E.

Valuations: to re-rate closer to peers

IPCA's exposure to stable domestic formulation business (39% of sales) and increasing scale-up in export formulations (35% of sales) provides attractive growth prospects at compelling valuations. IPCA is currently trading at 13.2x FY11E and 10.5x FY12E EPS, a steep ~30% discount to mid-size peers. We expect the valuation gap with peers to narrow with 24% EPS growth and a robust business model. We peg our PO of Rs333 at 13.5x FY12E EPS.

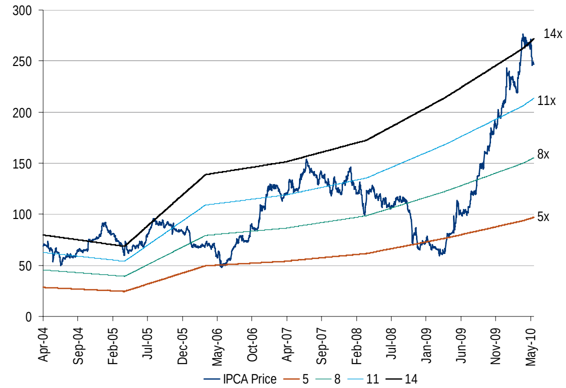
PO of Rs333 based on 13.5x FY12E EPS

We value IPCA on a target 1-year forward P/E multiple basis, the same methodology we use for other pharmaceutical stocks in our coverage. We have assigned a target P/E of 13.5x on FY12 E EPS of Rs24. This target multiple is–

- At ~20% discount to other mid-size peers, on lower scale of operations.
- Implies a PEG of 0.6x, which is better than the sector average of 0.7x
- At the higher end of IPCA's historic multiples, given significant growth in profitability and scale of operations.

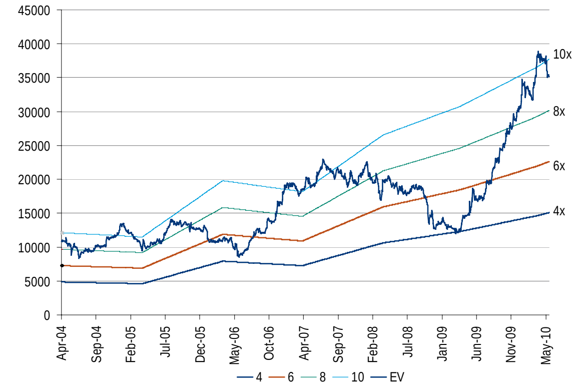
We believe this multiple is justified given robust earnings growth with improving revenue visibility. With a healthy Balance Sheet and improving return ratios, we expect re-rating of the stock closer to its peers.

Chart 22: IPCA – 1 year forward P/E bands



Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 23: IPCA – 1 year forward EV/EBITDA bands



Source: Bloomberg, BofA Merrill Lynch Global Research

Stock is undervalued for 24% earnings CAGR over FY10-12E

IPCA is expected to grow its earnings at a CAGR of 24% over FY10-12E, driven by robust 19% growth in revenues. With more than 47% revenues from domestic market, we find impact of currency appreciation on margins to be limited.

Moreover, possible upside from government tenders in Artimether-Lumefantrine formulations (anti-malaria) and earlier than expected approval Indore SEZ by USFDA can lead to upside risk. We find the current valuations rewarding for stable earnings growth.

Table 8: Indian Pharma coverage valuation comparables

		CMP	Mkt Cap	P/E (x)			EPS CAGR	EV/EBITDA (x)			RoE (%)			EV/Sales (x)		
Stock	QRQ	Rs	US$mn	FY10E	FY11E	FY12E	10-12E	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E
Dr Reddys	Underperform	1262	4,632	25.6x	21.5x	17.4x	21%	18.2x	15.6x	12.8x	23%	25%	24%	3.4x	3.0x	2.5x
Lupin	Buy	1808	3,497	23.6x	19.0x	14.6x	27%	17.1x	13.8x	10.8x	37%	32%	32%	3.5x	2.8x	2.3x
Cadila	Buy	605	2,692	24.3x	19.5x	14.6x	29%	16.3x	13.6x	10.8x	36%	33%	34%	3.7x	3.1x	2.5x
Divis	Buy	697	2,003	27.1x	21.7x	16.2x	29%	20.9x	16.4x	12.5x	25%	25%	27%	9.5x	7.3x	5.6x
Glenmark*	Buy	264	1,550	19.1x	14.3x	10.6x	34%	12.9x	9.1x	7.9x	9%	12%	18%	3.6x	2.9x	2.3x
Biocon	Buy	281	1,223	19.2x	15.0x	12.5x	24%	11.7x	9.7x	8.2x	18%	19%	20%	2.6x	2.2x	1.9x
GSK Pharma^	Underperform	2009	3,699	28.3x	25.0x	21.6x	15%	22.1x	18.9x	16.4x	28%	29%	29%	7.9x	6.7x	5.9x
IPCA*	Buy	243	662	16.3x	13.2x	10.5x	25%	11.7x	9.7x	8.1x	27%	27%	28%	2.5x	2.1x	1.7x
India Pharma sector average				23.2x	18.5x	14.3x	28%	16.2x	13.0x	10.5x	24%	25%	26%	4.4x	3.5x	2.9x

Source: BofA Merrill Lynch Global Research. *FY10 estimates, all others are actuals; ^ - Dec- ending; Average excludes IPCA Labs, Glaxo Pharma

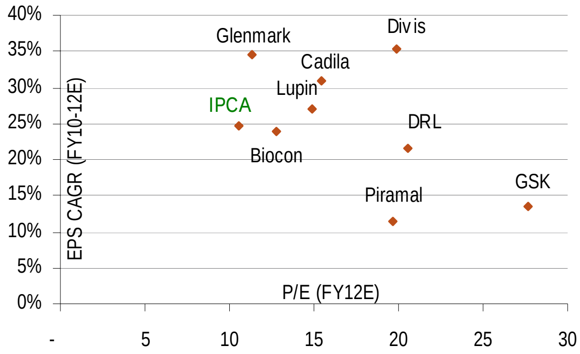
Alternate valuation methodology

At CMP, the stock is trading at 9.7x FY11E and 8.1x FY12E EBITDA. On an EV/EBITDA basis too, IPCA trades at ~20% discount to sector average multiple. At our PO, the stock would trade at 10.4x EV/EBITDA (1 yr forward) which we believe is justified given increasing scale of operations and steady profitability.

On an EV/Sales comparison too, IPCA stands out relatively cheap at 1.7x FY12E EV/Sales compared to peers average of 2.8x FY12E. We believe this gap would narrow as IPCA reaches higher scale of operations. At our PO the stock would trade at 2.2x FY12E sales, which is still a 20% discount to its peer average.

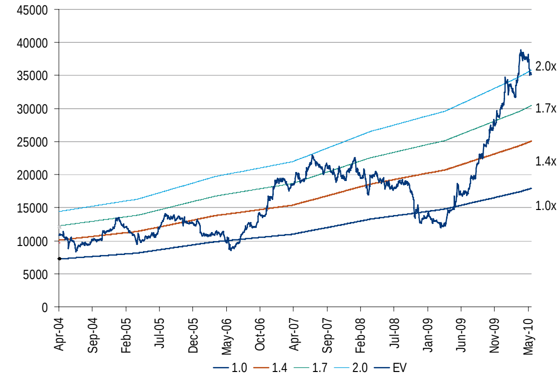
On a comparable valuation matrix, IPCA appears to be placed very attractively.

Chart 24: IPCA is attractively placed on comparative valuation matrix



Source: –BofA Merrill Lynch Global Research

Chart 25: IPCA – 1 year forward EV/Sales band



Source: Bloomberg, BofA Merrill Lynch Global Research

Financials

Table 9: Net Revenue Split

Geography-wise (in Rsmn)	FY08	FY09	FY10E	FY11E	FY12E
Formulations	*7736*	*9138*	*11095*	*13471*	*16566*
Domestic	4319	4766	5719	6749	7963
as % of total revenues	41%	38%	38%	38%	37%
Growth YoY (%)	22%	10%	20%	18%	18%
Exports	3417	4372	5376	6723	8602
as % of total revenues	33%	35%	36%	38%	40%
Growth YoY (%)	25%	28%	23%	25%	28%
Americas	*31*	*242*	*639*	*1094*	*1640*
Europe	*1873*	*1741*	*2419*	*2840*	*3408*
Australia	*55*	*90*	*147*	*187*	*234*
Total advanced markets	1960	2074	3205	4120	5282
CIS	*557*	*1023*	*882*	*1035*	*1294*
Asia	*204*	*177*	*183*	*215*	*269*
Africa	*696*	*1099*	*1105*	*1352*	*1757*
Total developing markets	1457	2298	2171	2602	3320
API	*2684*	*3516*	*4048*	*4405*	*4865*
Domestic	741	1083	1213	1274	1338
as % of total revenues	7%	9%	8%	7%	6%
Growth YoY (%)	5%	46%	12%	5%	5%
Exports	1943	2432	2834	3131	3527
as % of total revenues	19%	19%	19%	18%	16%
Growth YoY (%)	-8%	25%	17%	10%	13%
Americas	*533*	*680*	*782*	*857*	*960*
Europe	*675*	*819*	*926*	*996*	*1096*
Australia	*35*	*29*	*52*	*63*	*73*
Total advanced markets	1243	1528	1760	1917	2128
CIS	*12*	*16*	*58*	*71*	*84*
Asia	*560*	*708*	*800*	*900*	*1035*
Africa	*128*	*180*	*216*	*243*	*280*
Total developing markets	699	904	1074	1214	1399
Total revenues	10419	12653	15142	17876	21431
Growth YoY (%)	15%	21%	20%	18%	20%

Source: Company reports, BofA Merrill Lynch Global Research estimates

Table 10: Exports-breakup (as % of revenues)

	FY08	FY09	FY10E	FY11E	FY12E
Formulations-exports	33%	35%	36%	38%	40%
Americas	*0%*	*2%*	*4%*	*6%*	*8%*
Europe	*18%*	*14%*	*16%*	*16%*	*16%*
Australia	*1%*	*1%*	*1%*	*1%*	*1%*
Total advanced markets	19%	16%	21%	23%	25%
CIS	*5%*	*8%*	*6%*	*6%*	*6%*
Asia	*2%*	*1%*	*1%*	*1%*	*1%*
Africa	*7%*	*9%*	*7%*	*8%*	*8%*
Total developing markets	14%	18%	14%	15%	15%
API-exports	19%	19%	19%	18%	16%
Americas	*5%*	*5%*	*5%*	*5%*	*4%*
Europe	*6%*	*6%*	*6%*	*6%*	*5%*
Australia	*0%*	*0%*	*0%*	*0%*	*0%*
Total advanced markets	12%	12%	12%	11%	10%
CIS	*0%*	*0%*	*0%*	*0%*	*0%*
Asia	*5%*	*6%*	*5%*	*5%*	*5%*
Africa	*1%*	*1%*	*1%*	*1%*	*1%*
Total developing markets	7%	7%	7%	7%	7%
Total exports	51%	54%	54%	55%	57%
Total domestic	49%	46%	46%	45%	43%

Source: Company reports, BofA Merrill Lynch Global Research estimates

Table 11: IPCA: Profit model, March fiscal year-ends, FY08-FY12E

Rs. million	FY08	FY09	FY10E	FY11E	FY12E
Gross sales	10,977	13,263	15,142	17,876	21,431
Less: Excise	464	425	277	321	372
Excise as a % of domestic sales	9%	7%	4%	4%	4%
Net sales - consolidated	10,513	12,838	14,865	17,555	21,058
Other operating income	139	88	102	117	134
Net operating revenue	10,652	12,926	14,967	17,672	21,193
Expenditure schedule					
Cost of raw materials	4,639	5,073	5,872	6,934	8,318
(% net sales)	*44%*	*40%*	*40%*	*40%*	*40%*
Staff costs	1,470	1,882	2,221	2,621	3,092
(% net op. revenue)	*14%*	*15%*	*15%*	*15%*	*15%*
R & D Expenses	352	487	557	702	842
(% net op. revenue)	*3%*	*4%*	*4%*	*4%*	*4%*
Other expenses	2374	2832	3,122	3,599	4,317
(% net sales)	*23%*	*22%*	*21%*	*21%*	*21%*
Total expenditure	8,835	10,274	11,772	13,856	16,570
(% net op. revenue)	*80%*	*77%*	*78%*	*78%*	*77%*
EBITDA	1,817	2,653	3,195	3,816	4,623
EBITDA margins (as a % of net op. revs)	*17.3%*	*20.7%*	*21.5%*	*21.7%*	*22.0%*
Finance cost	240	378	330	333	327
Non-operating income	64	66	76	91	109
Forex gains/ (losses)	436	(762)			
EBDT	2,078	1,580	2,941	3,574	4,405
Depreciation	325	397	445	505	547
Pretax profit	1,753	1,183	2,496	3,069	3,858
Tax	298	203	462	568	694
Deferred tax	62	78	89	102	113
Associates income/Minority interest	(35)	57	62	67	72
Reported Profit after taxes	1,359	1,008	2,007	2,466	3,123
Adjusted net profit	1,355	1,542	2,007	2,466	3,123
Key parameters	FY08	FY09	FY10E	FY11E	FY12E
Dividends	235	323	501.7	616.4	780.8
DPS (Rs)	1.9	2.6	4.0	4.9	6.2
Payout ratio (X)	17%	32%	25%	25%	25%
Total debt/equity (X)	0.6x	0.7x	0.6x	0.5x	0.4x
EPS (Rs) Diluted	10.8	12.3	16.0	19.7	25.0
CEPS (Rs) Diluted	12.9	14.7	18.8	22.8	28.3
Book value/share (Rs)	47	50	62	77	96
RoE (%)	26%	25%	28%	28%	29%
RoCE (%)	15%	20%	21%	22%	23%
P/E (X)	22.4x	19.6x	15.1x	12.3x	9.7x
P / CEPS (X)	18.8x	16.5x	12.9x	10.6x	8.5x
Price / Book value (X)	5.2x	4.8x	3.9x	3.1x	2.5x
Fully-diluted shares (mn)	125.5	125.1	125.1	125.1	125.1
EV / Sales (X)	3.2x	2.7x	2.3x	2.0x	1.6x
EV / EBITDA (X)	18.6x	13.1x	11.0x	9.2x	7.6x
Effective tax rate (%)	20.5	23.7	22.1	21.8	20.9
Margins (%)					
Gross profit	56%	61%	61%	61%	61%
EBITDA	17%	21%	21%	22%	22%
PBT	16%	9%	17%	17%	18%
Net profit	13%	12%	13%	14%	15%
Growth (%)					
Net sales	14%	22%	16%	18%	20%
Staff costs	25%	28%	18%	18%	18%
EBITDA	-8%	46%	20%	19%	21%
Adjusted net profit	9%	14%	30%	23%	27%

Source: Company reports, BofA Merrill Lynch Global Research estimates

Table 12: IPCA: Balance sheet, March fiscal year-ends, FY08-12E

Rs. million	FY08	FY09	FY10E	FY11E	FY12E
Sources :					
Shareholders' funds					
Equity share capital	251	250	1,251	1,251	1,251
Reserves/surplus	5,641	6,063	6,497	8,257	10,488
Total Equity	5,892	6,313	7,748	9,508	11,739
Minority interest	-	(4)	(4)	(5)	(5)
Deferred tax liability	574	651	749	824	906
Loans					
Secured loans	3,003	3,408	3,579	3,400	3,332
Unsecured loans	527	1,191	1,251	1,276	1,340
Total Debt	3,530	4,599	4,829	4,675	4,671
Total	9,996	11,560	13,322	15,003	17,312
Applications:					
Fixed assets					
Gross block	5,789	7,790	9,090	10,440	11,790
Less: Acc. dep.	1,646	2,022	2,467	2,972	3,519
Net block	4,143	5,768	6,623	7,467	8,270
Capital – WIP	1,276	144	175	175	175
	5,420	5,912	6,798	7,642	8,445
Investments	95	412	324	141	104
Current assets, loans, advances					
Inventories	2,676	3,062	3,586	4,135	4,956
Sundry debtors	2,676	3,391	3,665	4,323	5,181
Cash/bank balance	94	113	319	376	451
Other current assets	-	-	-	-	-
Loans/advances	642	832	797	940	1,126
	6,088	7,398	8,367	9,775	11,713
Current liabilities/provisions					
Sundry creditors	1,371	1,962	1,967	2,320	2,669
Provisions	236	200	199	235	282
	1,607	2,162	2,166	2,555	2,951
Net current assets	4,481	5,236	6,200	7,219	8,762
Miscellaneous expenditure	0.0	0.2			
Total	9,996	11,560	13,322	15,003	17,312
Working capital ratios					
Inventory days <Days of net sales>	92.9	87.0	90.0	88.0	88.0
Debtor days <Days of net sales>	92.9	96.4	92.0	92.0	92.0
Cash / Net sales <Days of net sales>	3.3	3.2	8.0	8.0	8.0
Loans & advances days <Days of net sales>	22.3	23.6	20.0	20.0	20.0
Creditor days <Days of cost of goods sold>	107.9	141.2	125.0	125.0	120.0
Other liabilities / Net sales <Days of net sales>	8.2	5.7	5.0	5.0	5.0
Net working Capital days	92.0	60.3	72.0	70.0	75.0
D/E	0.60	0.73	0.62	0.49	0.40
Net Debt/Equity	0.57	0.65	0.54	0.44	0.35
WC/net sales%	42.06	40.51	42.34	41.80	42.35

Source: Company reports, BofA Merrill Lynch Global Research estimates

Price objective basis & risk

IPCA Labs (XBLAF)

Our PO of Rs333 is based on 13.5x FY12E EPS of Rs24.6. Our target multiple is at a discount to Indian pharma peers trading at 15x FY12E. Our PO is pegged at the upper end of its historic 1-yr forward P/E band as we believe re-rating is justified on higher growth outlook (24% earnings growth) and improving business mix. Higher upside from Artemether-Lumefantrine tender (WHO) and earlier than expected USFDA approval for Indore SEZ may provide upside triggers.

Downside risks: (a) International generics pricing pressure (b) regulatory delays and (c) foreign exchange fluctuation.

Link to Definitions

Healthcare

Click here for definitions of commonly used terms.

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India - Healthcare Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
BUY				
	BIOCON LTD	BCLTF	BIOS IN	Arvind Bothra
	CADILA HEALTHCAR	CDLHF	CDH IN	Arvind Bothra
	Divi's Lab	XXQPF	DIVI IN	Arvind Bothra
	Glenmark Pharm	XVQWF	GNP IN	Arvind Bothra
	IPCA Labs	XBLAF	IPCA IN	Arvind Bothra
	Lupin Limited	LPMCF	LPC IN	S.Arun
UNDERPERFORM				
	Dr Reddy's Lab	DRYBF	DRRD IN	S.Arun
	Dr Reddys Lab-A	RDY	RDY US	S.Arun
	GSK India	GXOLF	GLXO IN	Arvind Bothra
	Piramal Healthcare Ltd	XNIGF	PIHC IN	Arvind Bothra
RSTR				
	Sun Pharma	SPCEF	SUNP IN	S.Arun
RVW				
	Panacea Biotec	XPEAF	PNCB IN	Arvind Bothra

iQmethod SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	104	50.98%	Buy	60	60.61%
Neutral	55	26.96%	Neutral	33	66.00%
Sell	45	22.06%	Sell	27	62.79%

Investment Rating Distribution: Global Group (as of 01 Apr 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1818	52.41%	Buy	952	58.01%
Neutral	873	25.17%	Neutral	490	61.95%
Sell	778	22.43%	Sell	355	49.72%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BofAML Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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