

Indoco Remedies

Performance Highlights

Y/E March (₹ cr)	2QFY12	1QFY12	% chg (qoq)	2QFY12	% chg (yoy)
Net sales	145	135	7.3	132	9.4
Other operating income	3	3	(10.3)	3	(12.6)
Gross profit	78	70	11.9	72	9.3
Operating profit	18	16	15.4	13	34.5
Net profit	14	12	17.3	15	(9.4)

Source: Company, Angel Research

For 2QFY2012, Indoco Remedies (Indoco) declared in-line results at the revenue front, reporting growth of 9.4% yoy. However, on the net profit front, growth came in lower than expected, declining by 9.4% yoy. This was mainly on account of OPM declining by 95bp yoy to 12.4% (13.4%), lower than our estimates. The domestic formulation segment grew moderately by 5.3% yoy during the quarter, contributing 64.4% to the total revenue, whereas formulations exports increased by 23.6% yoy.

We recommend Buy on the stock.

Domestic segment disappoints: Indoco reported net sales of ₹145cr (₹132cr), up 9.4% yoy, almost in-line with our expectation of ₹148cr for 2QFY2012, mainly on account of lower sales from the domestic high-margin formulations segment. Gross margin came in at 54.2%, in-line with 2QFY2011. OPM decreased by 95bp yoy to 12.4% (13.4%). Net profit for the quarter came in at ₹13.8cr, 23.7% below our estimate of ₹18.1cr.

Outlook and valuation: We expect net sales to post a 19.6% CAGR to ₹685cr and EPS to post a 15.6% CAGR to ₹55.5 over FY2011-13E. At ₹373, the stock is trading at 8.8x and 6.7x FY2012E and FY2013E earnings, respectively. **We recommend Buy on the stock with a revised target price of ₹583.**

Key financials (Consolidated)

Y/E March (₹ cr)	FY2010	FY2011E	FY2012E	FY2013E
Net sales	398.3	478.5	559.8	685.0
% chg	13.6	20.1	17.0	22.4
Net profit	42.0	51.0	52.2	68.2
% chg	33.5	21.5	2.2	30.7
EPS (₹)	34.3	41.5	42.5	55.5
EBITDA margin (%)	13.3	13.5	14.7	15.2
P/E (x)	10.9	9.0	8.8	6.7
RoE (%)	14.3	15.5	14.3	16.9
RoCE (%)	10.8	11.6	12.6	14.2
P/BV (x)	1.5	1.3	1.2	1.1
EV/Sales (x)	1.2	1.1	1.0	0.9
EV/EBITDA (x)	9.2	8.2	6.7	5.6

Source: Company, Angel Research

BUY

CMP	₹373
Target Price	₹583

Investment Period	12 months
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Stock Info	
Sector	Pharmaceutical
Market Cap (₹cr)	457
Beta	0.4
52 Week High / Low	552/360
Avg. Daily Volume	2,195
Face Value (₹)	10
BSE Sensex	17,805
Nifty	5,361
Reuters Code	INRM.BO
Bloomberg Code	INDR@IN

Shareholding Pattern (%)	
Promoters	61.0
MF / Banks / Indian Fls	15.3
FII / NRIs / OCBs	3.6
Indian Public / Others	20.1

Abs. (%)	3m	1yr	3yr
Sensex	(2.2)	(10.7)	97.7
Indoco	(12.7)	(26.1)	129.7

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Exhibit 1: 2QFY2012 performance

Y/E March (₹ cr)	2QFY2012	1QFY2012	% chg (qoq)	2QFY2011	% chg (yoy)	1HFY2011	1HFY2010	% chg (yoy)
Net sales	145	135	7.3	132	9.4	270	244	10.9
Other income	3	3	(10.3)	3	(12.6)	4	4	(0.0)
Total income	147	138	6.9	135		274	248	10.7
Gross profit	78	70	11.9	72	9.3	150	116	29.4
Gross margin (%)	54.2	51.9		54.2		55.5	56.3	
Operating profit	18.0	15.6	15.4	17.7	1.6	35.1	35.3	(0.6)
OPM (%)	12.4	11.6		13.4		13.0	14.5	
Interest	1	1	63.6	1	171.7	2	1	96.6
Dep. & amortization	5	4	19.4	3	39.7	9	7	31.1
PBT	12	11	10.1	14	(14.1)	28	32	(11.1)
Provision for taxation	0.8	2.1	(61.2)	1.7	(52.9)	2.9	2.1	36.8
Reported Net profit	14	12	17.3	15	(9.4)	26	30	(14.4)
Less : Exceptional items	-	-	-	-	-	-	-	-
PAT after exceptional items	14	12	17.3	15	(9.4)	26	30	(14.4)
EPS (₹)	11.2	9.6		12.4		20.8	24.5	

Source: Company, Angel Research

Exhibit 2: 2QFY2012 – Actual vs. Angel estimates

(₹ cr)	Actual	Estimate	Variation (%)
Net sales	145	148	(2.3)
Other operating income	3	3	(12.6)
Operating profit	18	23	(21.6)
Tax	1	4	(79.5)
Net profit	14	18	(23.7)

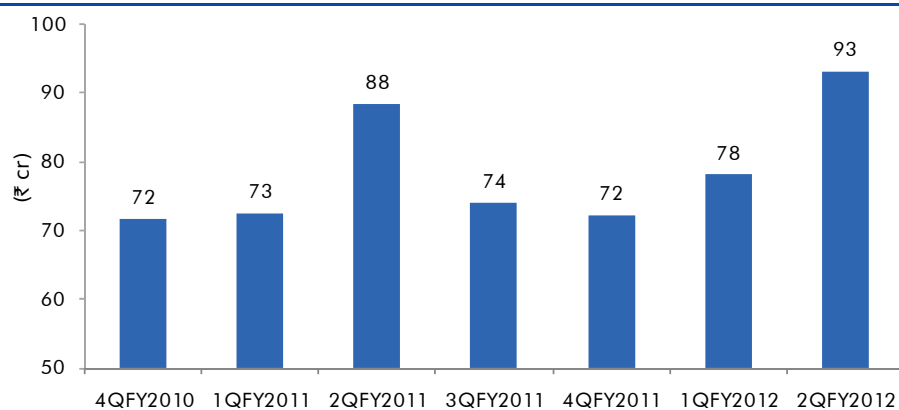
Source: Company, Angel Research

Revenue lower than expectations, domestic formulations report lower growth: For 2QFY2012, Indoco reported net sales of ₹144.7cr (₹132.3cr), up 9.4% yoy, lower than our expectation of ₹148cr, mainly on account of lower sales from the domestic high-margin formulation segment.

Revenue from the regulated market grew by 32.8% to ₹36.0cr in 2QFY2012 as against ₹27.0cr in 2QFY2011. Revenue from emerging markets came in at ₹7.6cr as against ₹8.2cr in 2QFY2011. API export sales stood at ₹3.1cr as compared to ₹5.1cr during 2QFY2011.

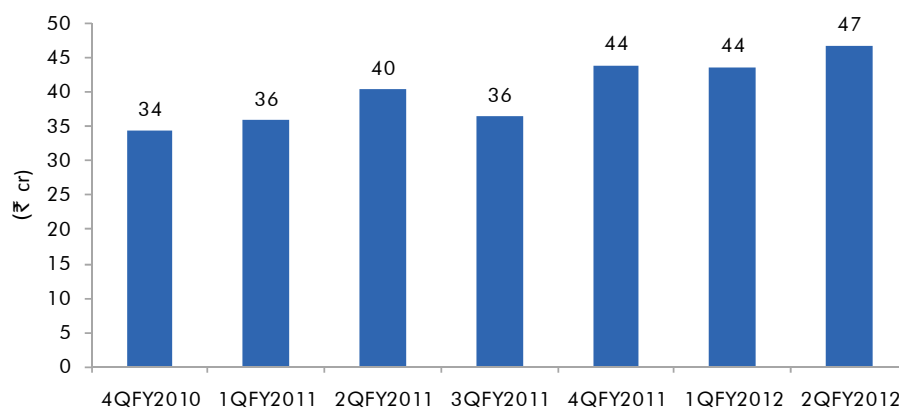
During the quarter, export revenue included business from a major tender for the sale of Allopurinol. Patalganga manufacturing unit has been approved by an MNC for the supply of Allopurinol, which is likely to be commercialized soon. In addition to this, the company has signed two major export contracts for supplying an API product over three years to a customer in Europe. Also, the company is working closely with Aspen Pharmacare Limited and is adding new products/projects, thus expanding its overall portfolio.

Exhibit 3: Domestic formulation sales trend



Source: Company, Angel research

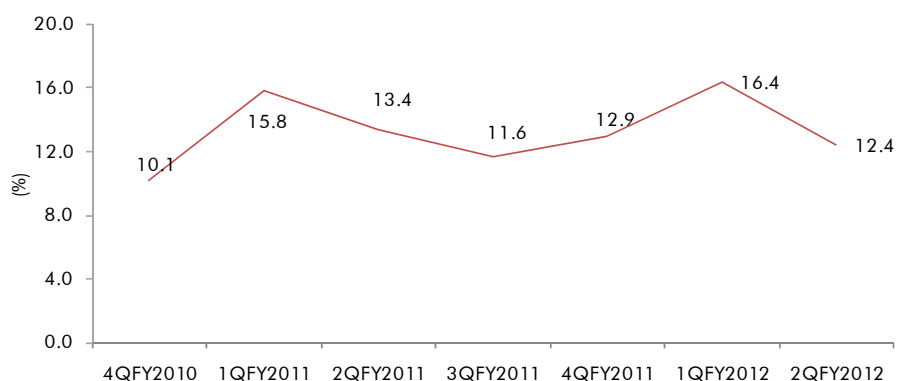
Exhibit 4: Export sales trend



Source: Company, Angel research

OPM below estimates: For 2QFY2012, Indoco's gross margin came in-line with our expectation at 54.2%. The domestic formulation segment grew moderately during the quarter, contributing 64.4% to the total sales in 2QFY2012 vis-à-vis 66.8% in 2QFY2011. Consequently, OPM for the quarter came in at 12.4% (13.4%), registering a decrease of 95bp yoy.

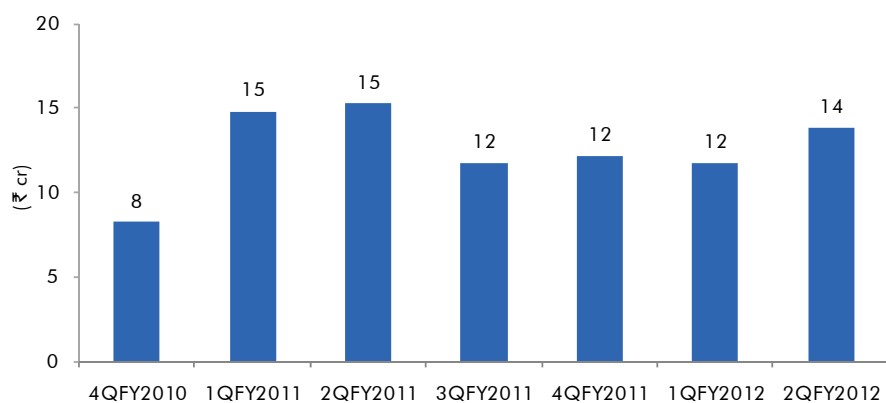
Exhibit 5: OPM trend



Source: Company, Angel Research

Net profit below expectation: Indoco reported net profit of ₹13.8cr, 23.7% below our estimate of ₹15.3cr, majorly led by lower operating margin. Tax guidance for FY2012E is around 20%.

Exhibit 6: Net profit trend



Source: Company, Angel Research

Concall takeaways

- For FY2012, management has maintained its guidance of 20% growth, with 2HFY2012 expected to be more robust than 1HFY2012.
- The commercialization of the Watson deal would start from September 2012, with the launch of two products.
- Supply Metformin tablet has already started for AOK-Germany tender and will give consistent revenue to the company for the next two years. The company is also participating in the new AOK tender with additional products – the results of which are expected to come in the next quarter.

Investment arguments

Domestic formulations back on the growth trajectory: Indoco has a strong brand portfolio of 120 products and a base of 1,800MRs. The company operates in various therapeutic segments, including anti-infective, anti-diabetic, CVS, ophthalmic, dental care, pain management and respiratory. Prominent Indoco brands include *Cyclopam*, *Vepan*, *Febrex Plus*, *ATM*, *Sensodent-K* and *Sensoform*. The company's top 10 brands contribute 60% to domestic sales. Post the restructuring of the domestic business in FY2009, which has resulted in improvement in working capital cycle, Indoco is back on the growth trajectory with its domestic formulation business, outpacing the industry growth rate in the last two quarters. The company has seen strong growth across the respiratory, anti-infective, ophthalmic and alimentary therapeutic segments. Further, the company plans to increase its sales force by 180MRs in FY2012E to increase its penetration in tier-II/rural markets.

Scaling-up on the export front: Indoco has also started focusing on regulated markets by entering into long-term supply contracts. The company is currently executing several contract-manufacturing projects, covering a number of products for its clients in the UK, Germany and Slovenia. The company is in the process of signing the supply agreement with the AOK tender winner and, hence, expects to resume supplies of *Metformin* tablets to AOK, Germany, from 2QFY2012E. The company has indicated capex of ₹90cr for FY2012E, which includes ₹55cr for the construction been undertaken near the API facility in Patalganga, expected to be completed over the next 18 months, which would cater to the increase in export demand.

Watson and Aspen Pharma contract – A long-term growth driver: Indoco has entered into a supply agreement for ophthalmic products with Watson (US market) and Aspen Pharma (emerging markets). Although milestone payments from the contracts have commenced in FY2011, we expect substantial revenue flow from the deals to commence from FY2013-14. Post the new product development (basket of 5-6 products) deals signed with Aspen Pharma to extend its reach to Europe and Australia, Indoco further extended the manufacturing agreement with Aspen in 4QFY2011, thus increasing its solid dosage product portfolio to 12 for the year. These products would cater to Aspen's requirement in the Latin American and Sub-Saharan African markets. Also, the company has signed a contract research deal with Aspen, where it would cater to Aspen's global requirement. This contract currently is for products in the oral solids category.

Valuations: For FY2012, management has maintained its guidance of 20% growth, with 2HFY2012 expected to be more robust than 1HFY2012. We expect net sales to post a 19.6% CAGR to ₹685cr and EPS to post a 15.6% CAGR to ₹55.5 over FY2010-13E. **At ₹386, the stock is trading at 9.1x and 6.9x FY2012E and FY2013E earnings, respectively. We recommend Buy on the stock with a revised target price of ₹583.**

Exhibit 7: Key assumptions

	FY2012E	FY2013E
Domestic sales growth (%)	9.7	14.4
Export sales growth (%)	32.8	35.9
Operating margins (%)	14.7	15.8
Capex (₹ cr)	60.0	60.0

Source: Company, Angel Research

Exhibit 8: One-year forward PE band


Source: Company, Angel Research

Exhibit 9: Recommendation summary

Company	Reco	CMP (₹)	Tgt. price (₹)	Upside %	FY2013E			FY11-13E	FY2013E	
					PE (x)	EV/Sales (x)	EV/EBITDA (x)	CAGR in EPS (%)	RoCE (%)	RoE (%)
Alembic Pharmaceuticals	Buy	45	77	70.2	5.9	0.4	2.9	30.6	26.6	37.0
Aurobindo Pharma	Buy	128	217	68.9	6.7	1.0	5.5	29.5	13.8	19.0
Aventis*	Sell	2,322	1,937	(16.6)	25.8	3.3	21.4	15.6	15.8	17.1
Cadila Healthcare	Buy	774	1,053	36.0	15.1	2.4	11.9	21.6	28.3	35.2
Cipla	Buy	299	369	23.6	16.2	2.9	13.9	23.8	17.0	18.2
Dr Reddy's	Buy	1,652	1,920	16.2	17.2	3.0	11.8	22.7	17.7	25.2
Dishman Pharma	Buy	53	85	60.0	4.5	1.1	6.1	8.6	7.4	9.2
GSK Pharma*	Neutral	2,122	-	-	24.4	5.6	15.7	14.6	41.0	30.7
Indoco Remedies	Buy	373	583	76.6	6.7	0.9	5.6	15.6	14.2	16.9
Ipca labs	Buy	239	358	50.0	8.7	1.3	6.2	14.8	23.3	24.9
Lupin	Buy	474	593	25.1	16.0	2.6	13.3	24.0	23.9	30.8
Orchid Chemicals	Buy	162	270	66.5	4.4	1.2	5.3	29.6	11.7	23.4
Ranbaxy*	Accumulate	513	578	12.7	9.7	1.6	6.7	43.1	26.8	25.9
Sun Pharma	Neutral	509	-	-	21.6	5.4	17.3	15.8	20.2	20.4

Source: Company, Angel Research *December ending

Profit & loss statement (Consolidated)

Y/E March (₹ cr)	*FY2008	FY2009	FY2010	FY2011	FY2012E	FY2013E
Gross sales	272	355	402	484	567	693
Less: Excise duty	9	5	4	5	7	8
Net sales	263	351	398	478	560	685
Other operating income	1	2	5	8	7	9
Total operating income	264	352	403	486	566	694
% chg	(19.2)	33.6	14.4	20.7	16.5	22.5
Total expenditure	220	304	345	414	477	581
Net raw materials	113	150	174	213	253	307
Other mfg costs	26	38	46	29	34	40
Personnel	32	48	56	67	73	89
Other	49	68	69	105	118	144
EBITDA	43	46	53	64	82	104
% chg	(27.6)	8.1	14.8	21.5	27.9	26.5
(% of Net Sales)	16.3	13.2	13.3	13.5	14.7	15.2
Depreciation& amort.	8	11	12	13	19	21
EBIT	35	35	41	51	64	83
% chg	(30.1)	0.3	16.8	24.5	25.1	30.0
(% of Net Sales)	13.3	10.0	10.3	10.7	11.4	12.1
Interest & other charges	4	6	3	2	6	8
Other income	2	2	0	0	2	2
(% of PBT)	4.4	7.0	0.4	0.1	3.0	2.3
Recurring PBT	34	33	43	57	66	86
% chg	(29.3)	(2.1)	29.8	31.3	17.0	29.6
Extraordinary expense/(Inc.)	1.8	-	-	-	-	-
PBT (reported)	32	33	43	57	66	86
Tax	2	2	1	5	14	18
(% of PBT)	6.1	5.1	2.4	9.7	21.1	20.5
PAT (reported)	30	31	42	51	52	68
PAT after MI (reported)	30	31	42	51	52	68
ADJ. PAT	32	31	42	51	52	68
% chg	(26.3)	(1.4)	33.5	21.5	2.2	30.7
(% of Net Sales)	11.5	9.0	10.5	10.7	9.3	10.0
Basic EPS (₹)	24.5	25.6	34.3	41.5	42.5	55.5
Fully Diluted EPS (₹)	24.5	25.6	34.3	41.5	42.5	55.5
% chg	(31.1)	4.4	33.9	21.3	2.2	30.7

Note: *For the nine months ended March 31, 2008

Balance Sheet (Consolidated)

Y/E March (₹ cr)	*FY2008	FY2009	FY2010	FY2011E	FY2012E	FY2013E
SOURCES OF FUNDS						
Equity share capital	12	12	12	12	12	12
Reserves & surplus	242	266	298	338	365	417
Shareholders' funds	254	278	311	350	377	430
Total loans	34	56	66	100	126	165
Deferred tax liability	22	23	24	26	33	38
Total liabilities	310	357	401	476	536	632
APPLICATION OF FUNDS						
Gross block	219	234	268	296	413	473
Less: acc. depreciation	47	58	70	83	105	126
Net block	172	176	197	213	308	346
Capital work-in-progress	2	16	31	82	25	25
Investments	0.0	0.0	0.2	0.0	0.2	0.2
Current assets	199	223	251	268	312	390
Cash	16	29	38	27	28	39
Loans & advances	31	42	53	69	67	82
Other	152	153	160	172	217	268
Current liabilities	63	59	78	87	108	129
Net current assets	137	165	173	181	203	261
Mis. Exp. not written off	0.4	0.1	0.1	0.0	0.1	0.1
Total assets	310	357	401	476	536	632

Note: *For the nine months ended March 31, 2008

Cash Flow Statement (Consolidated)

Y/E March (₹ cr)	*FY2008	FY2009	FY2010	FY2011	FY2012E	FY2013E
Profit before tax	34	33	43	57	66	86
Depreciation	8	11	12	13	19	21
(Inc)/Dec in working capital	(8)	(5)	1	(2)	(21)	(45)
Less: Other income	2	2	0	0	2	2
Direct taxes paid	7	5	8	5	11	13
Cash Flow from Operations	26	32	48	62	51	47
(Inc.)/Dec.in fixed assets	(15)	(30)	(48)	(80)	(59)	(60)
(Inc.)/Dec. in investments	(0)	-	-	-	0	-
Other income	2	2	0	0	2	2
Cash Flow from Investing	(14)	(28)	(48)	(80)	(57)	(58)
Issue of equity	-	-	-	-	-	-
Inc./Dec.) in loans	(1)	21	13	75	40	39
Dividend Paid (Incl. Tax)	(9)	(12)	(3)	(10)	(12)	(16)
Others	(1)	(1)	(2)	(68)	(34)	(16)
Cash Flow from Financing	(11)	8	8	(3)	(6)	7
Inc./Dec.) in Cash	1	13	9	(10)	1	12
Opening Cash balances	15	16	29	38	27	28
Closing Cash balances	16	29	38	27	28	39

Note: *For the nine months ended March 31, 2008

Key Ratios

Y/E March	*FY2008	FY2009	FY2010	FY2011	FY2012E	FY2013E
Valuation Ratio (x)						
P/E (on FDEPS)	15.2	14.6	10.9	9.0	8.8	6.7
P/CEPS	12.1	10.7	8.5	7.1	6.5	5.1
P/BV	1.8	1.6	1.5	1.3	1.2	1.1
Dividend yield (%)	1.3	1.4	1.9	2.2	2.3	3.0
EV/Sales	1.8	1.4	1.2	1.1	1.0	0.9
EV/EBITDA	11.1	10.5	9.2	8.2	6.7	5.6
EV / Total Assets	1.5	1.4	1.2	1.1	1.0	0.9
Per Share Data (₹)						
EPS (Basic)	24.5	25.6	34.3	41.5	42.5	55.5
EPS (fully diluted)	24.5	25.6	34.3	41.5	42.5	55.5
Cash EPS	30.8	34.7	44.0	52.5	57.7	72.9
DPS	5.0	5.1	7.0	8.3	8.5	11.1
Book Value	206.9	226.6	252.7	285.0	307.1	349.6
Dupont Analysis						
EBIT margin	13.3	10.0	10.3	10.7	11.4	12.1
Tax retention ratio	93.9	94.9	97.6	90.3	78.9	79.5
Asset turnover (x)	0.9	1.1	1.2	1.2	1.2	1.3
ROIC (Post-tax)	11.6	10.7	11.7	11.5	10.6	12.1
Cost of Debt (Post Tax)	9.7	12.4	4.7	2.6	4.4	4.5
Leverage (x)	0.1	0.1	0.1	0.1	0.2	0.3
Operating ROE	11.8	10.6	12.4	12.9	12.1	14.2
Returns (%)						
ROCE (Pre-tax)	11.7	10.5	10.8	11.6	12.6	14.2
Angel ROIC (Pre-tax)	12.4	11.6	12.7	14.6	15.0	15.8
ROE	13.1	11.8	14.3	15.5	14.3	16.9
Turnover ratios (x)						
Asset Turnover (Gross Block)	1.2	1.6	1.6	1.7	1.6	1.6
Inventory / Sales (days)	57	50	55	53	51	22
Receivables (days)	110	108	86	75	78	35
Payables (days)	56	41	39	40	42	46
WC cycle (ex-cash) (days)	156	133	123	109	106	104
Solvency ratios (x)						
Net debt to equity	0.1	0.1	0.1	0.2	0.3	0.3
Net debt to EBITDA	0.4	0.6	0.5	1.1	1.2	1.2
Interest Coverage (EBIT/Int.)	9.7	6.0	14.1	21.2	10.1	10.0

Note: *For the nine months ended March 31, 2008

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Disclosure of Interest Statement	Indoco Remedies
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹ 1 lakh for Angel, its Group companies and Directors

Ratings (Returns):	Buy (> 15%) Reduce (-5% to 15%)	Accumulate (5% to 15%) Sell (< -15%)	Neutral (-5 to 5%)
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