

Exports boost 3Q; Raise estimates & PO



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Strong 3Q, Indore SEZ approval imminent; Raise est & PO

3Q adj. profits at Rs944mn (up 68% YoY) beat BofAMLe (by 5%), led by strong export growth (up 73% YoY). Key surprise was sustained strong margins (24.6%, up 509bps YoY) despite weak domestic business (up 6% YoY, vs 10% est). Moreover, likely USFDA approval for Indore SEZ within 3 mths should be a key trigger, opening up growth in US as well as fixed cost absorption (Rs20mn/mth). We raise our FY12-14E est. by 10-20% to factor Indore SEZ contribution & higher margins and our PO to Rs375 from Rs330, based on 14x FY13E, justified on 25% EPS CAGR.

Exports growth surprised positively

Strong export formulations (up 73% YoY) drove topline growth of 32% (Rs6.1bn). Export formulations sales at Rs2.9bn (47% of sales) were driven by 3x jump in anti-malarial tender business (Rs925mn) while both branded & generic exports grew by 32-45%. Favorable realisation on exports (up ~10%) also drove 3Q growth. Domestic formulations growth still lagged industry at 6% YoY (7% YTD), mainly on weak anti-malarial business as well as top brands restructuring.

Margin outlook stronger

3Q margins grew 509bps YoY to 24.6% (23% est), resulting in EBITDA growth of 66% YoY (Rs1.5bn). Higher US\$ realisation (up 10%) aided margins by ~300bps, while stronger tender business also helped. We raise our FY13-14E margin outlook to ~21.5% (vs ~19% earlier) led by (a) rebound in domestic growth to 15% (vs 7% YTD), (b) US supplies from Indore SEZ (1QFY13), absorbing fixed costs.

Management call highlights:

(a) Anti-malarial tender sales to cross Rs3bn for FY12E (Rs2.4bn YTD) & grow 20% annually, (b) Expect 6 ANDAs to be approved (of 12 pending) from Indore SEZ in next 3 mths, along with site clearance (no '483 observations during inspection), (c) Domestic growth likely to revert to 15%+ from 4QFY12, with key therapies (CVS, Pain) performance improving.

Estimates (Mar)

(Rs)	2010A	2011A	2012E	2013E	2014E
Net Income (Adjusted - mn)	2,054	2,628	2,764	3,355	4,311
EPS	16.42	21.01	22.10	26.82	34.46
EPS Change (YoY)	103.7%	28.0%	5.2%	21.4%	28.5%
Dividend / Share	2.80	3.20	3.50	4.00	4.25
Free Cash Flow / Share	3.72	5.22	13.73	20.88	24.12

Valuation (Mar)

	2010A	2011A	2012E	2013E	2014E
P/E	18.18x	14.21x	13.51x	11.13x	8.66x
Dividend Yield	0.938%	1.07%	1.17%	1.34%	1.42%
EV / EBITDA*	13.22x	11.62x	8.62x	7.82x	6.54x
Free Cash Flow Yield*	1.25%	1.75%	4.60%	7.00%	8.08%

* For full definitions of *iQmethod*SM measures, see page 6.

Stock Data

Price	Rs298.45
Price Objective	Rs375.00
Date Established	31-Jan-2012
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs225.00-Rs351.95
Mkt Val / Shares Out (mn)	US\$750 / 125.1
Market Value (mn)	Rs37,336
Average Daily Volume	79,398
BofAML Ticker / Exchange	XBLAF / BSE
Bloomberg / Reuters	IPCA IN / IPCA.BO
ROE (2012E)	23.7%
Net Dbt to Eqty (Mar-2011A)	49.5%
Est. 5-Yr EPS / DPS Growth	22.0% / 15.0%
Free Float	53.8%

Key Changes

(Rs)	Previous	Current
Price Obj.	330.00	375.00
2012E Rev (m)	21,611.3	23,463.6
2013E Rev (m)	25,233.2	26,358.3
2014E Rev (m)	29,495.0	30,505.2
2012E EPS	19.96	22.10
2013E EPS	23.67	26.82
2014E EPS	28.57	34.46

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Refer to important disclosures on page 7 to 9. Analyst Certification on Page 5. Price Objective Basis/Risk on page 5. Link to Definitions on page 5. 11131961

iQprofileSM IPCA Labs

Key Income Statement Data (Mar)	2010A	2011A	2012E	2013E	2014E
(Rs Millions)					
Sales	15,666	18,989	23,464	26,358	30,505
Gross Profit	9,210	11,224	14,380	16,142	18,675
Sell General & Admin Expense	(5,331)	(6,750)	(8,376)	(9,504)	(10,773)
Operating Profit	2,838	3,203	4,390	4,817	5,870
Net Interest & Other Income	(176)	204	(824)	(383)	(315)
Associates	NA	NA	NA	NA	NA
Pretax Income	2,663	3,407	3,566	4,433	5,555
Tax (expense) / Benefit	(627)	(784)	(807)	(1,084)	(1,249)
Net Income (Adjusted)	2,054	2,628	2,764	3,355	4,311
Average Fully Diluted Shares Outstanding	125	125	125	125	125

Key Cash Flow Statement Data

Net Income	2,054	2,628	2,764	3,355	4,311
Depreciation & Amortization	467	558	681	774	818
Change in Working Capital	(1,664)	(1,203)	(1,966)	(1,241)	(1,769)
Deferred Taxation Charge	142	14	23	27	27
Other Adjustments, Net	727	476	1,684	1,524	1,629
Cash Flow from Operations	1,726	2,474	3,187	4,438	5,017
Capital Expenditure	(1,261)	(1,821)	(1,469)	(1,826)	(2,000)
(Acquisition) / Disposal of Investments	NA	NA	NA	NA	NA
Other Cash Inflow / (Outflow)	86	(83)	55	(552)	(1,338)
Cash Flow from Investing	(1,174)	(1,904)	(1,414)	(2,378)	(3,338)
Shares Issue / (Repurchase)	0	1	0	0	0
Cost of Dividends Paid	(350)	(400)	(438)	(500)	(532)
Cash Flow from Financing	(558)	(574)	(1,430)	(1,430)	(1,508)
Free Cash Flow	466	653	1,718	2,612	3,017
Net Debt	4,437	5,205	5,496	5,398	5,810
Change in Net Debt	(49)	767	291	(98)	412

Key Balance Sheet Data

Property, Plant & Equipment	6,379	6,992	8,561	9,787	10,969
Other Non-Current Assets	708	1,540	703	1,081	2,419
Trade Receivables	3,880	4,637	5,871	6,603	7,646
Cash & Equivalents	108	104	447	1,077	1,247
Other Current Assets	5,004	5,846	6,892	7,751	8,976
Total Assets	16,078	19,118	22,474	26,299	31,257
Long-Term Debt	4,545	5,308	5,943	6,475	7,057
Other Non-Current Liabilities	793	807	888	977	1,075
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	2,097	2,493	2,808	3,158	3,657
Total Liabilities	7,435	8,609	9,638	10,609	11,788
Total Equity	8,643	10,509	12,835	15,689	19,468
Total Equity & Liabilities	16,078	19,118	22,474	26,299	31,257

iQmethodSM - Bus Performance*

Return On Capital Employed	17.0%	16.1%	18.7%	17.0%	17.9%
Return On Equity	27.5%	27.4%	23.7%	23.5%	24.5%
Operating Margin	18.2%	17.0%	18.8%	18.4%	19.4%
EBITDA Margin	21.1%	19.8%	21.6%	21.2%	21.9%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	0.8x	0.9x	1.2x	1.3x	1.2x
Asset Replacement Ratio	2.7x	3.3x	2.2x	2.4x	2.4x
Tax Rate (Reported)	23.6%	23.0%	22.6%	24.5%	22.5%
Net Debt-to-Equity Ratio	51.3%	49.5%	42.8%	34.4%	29.8%
Interest Cover	10.8x	10.2x	12.0x	10.3x	14.5x

Key Metrics

* For full definitions of iQmethodSM measures, see page 6.

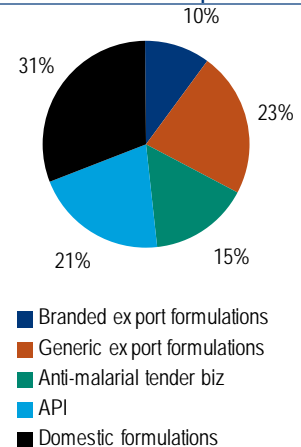
Company Description

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 leader in anti-malarials and Rheumatoid-Arthritis segments in domestic market. Leveraging its strength in API, IPCA has been successful in its export formulations strategy, with recent entry into 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 25% EPS growth over the next two years driven by 15% 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 – 3Q business split



Source: Company

Stock Data

Price to Book Value 2.9x

3QFY12 Result analysis

Table 1: IPCA Labs: Quarterly results, March fiscal year ends

Year to Mar (Rs mn)	Dec-10	Sep-11	Dec-11	YoY	QoQ	9MFY11	9MFY12	YoY	Comments
Formulations									
Domestic	1,775	2,292	1,876	6%	-18%	5,676	6,058	7%	Domestic growth in the quarter was muted due to (a) weakness in anti-infectives, cardiac segments due to restructuring. Likely to improve from 4Q itself with secondary mkt showing rebound Higher realisation (-10%) aided export formulation growth. Sales driven by strong 46% growth in branded formulations business and anti-malarial tender sales growing 3-fold to Rs925mn (vs Rs324mn last year). Generics export grew 32%, mainly led by US. Sales growth led by export formulations
Export	1,671	2,605	2,898	73%	11%	4,642	7,569	63%	
Total formulations	3,446	4,897	4,774	39%	-3%	10,319	13,627	32%	
API									
Domestic	322	356	333	3%	-7%	1,090	1,096	1%	API sales affected due to higher captive usage. Rupee depreciation helped partially
Exports	865	927	911	5%	-2%	2,513	2,739	9%	
Total API	1,187	1,283	1,244	5%	-3%	3,602	3,835	6%	Includes retrospective provision for focus mkt sales promotion benefit (Rs50mn for 1HFY12)
Others	30	55	130	333%	138%	105	221	111%	
Net Revenues	4664	6235	6148	32%	-1%	14026	17682	26%	Overall sales came in 4% above BofAMLe on strong exports Gross margins improved 291bps YoY, margin gains restricted due to weaker domestic formulations contribution
Cost of raw materials	1,912	2,435	2,342	22%	-4%	5,705	6,880	21%	
<i>% of Net Sales</i>	<i>41.0%</i>	<i>39.0%</i>	<i>38.1%</i>	<i>(291bps)</i>	<i>(96bps)</i>	<i>40.7%</i>	<i>38.9%</i>	<i>(176bps)</i>	Improved realisation boosted gross margins by ~300bps
Staff costs	649	728	804	24%	10%	2,007	2,368	18%	Staff cost increased YoY to factor wage hikes as well as new additions
<i>% of Net Sales</i>	<i>13.9%</i>	<i>11.7%</i>	<i>13.1%</i>	<i>(85bps)</i>	<i>140bps</i>	<i>14.3%</i>	<i>13.4%</i>	<i>(92bps)</i>	
SG&A expenses	1,193	1,492	1,490	25%	0%	3,513	4,390	25%	Low overheads associated with tender sales ((15% of sales), helped lower costs
<i>% of Net Sales</i>	<i>25.6%</i>	<i>23.9%</i>	<i>24.2%</i>	<i>(133bps)</i>	<i>31bps</i>	<i>25.0%</i>	<i>24.8%</i>	<i>(22bps)</i>	
Total expenditure	3,754	4,655	4,636	23%	0%	11,224	13,637	22%	
EBITDA	910	1580	1513	66%	-4%	2802	4045	44%	EBITDA was 5% above expectations despite weak domestic business, thanks to stronger tender biz
EBITDA margin (%)	19.5%	25.3%	24.6%	509bps	(74bps)	20.0%	22.9%	290bps	EBITDA margins expanded 509bps YoY, with currency aiding by 300bps and rest from higher tender sales
Other income	4	26	39	1026%	49%	17	92	449%	
Forex gains/ (losses)	112	(272)	(399)	-456%	47%	371	(579)	-256%	Forex losses relate largely to forward hedges only.
Interest	56	118	108	93%	-8%	167	309	85%	Debt remained, largely at same levels as Sep-11
Depreciation	142	176	181	28%	3%	408	511	25%	In line with last 2-3 quarters
Pre-tax profits	828	1,042	864	4%	-17%	2,616	2,738	5%	Higher forex losses suppressed PBT growth, excluding which PBT grew 76% YoY
Tax	188	262	225	19%	-14%	648	702	8%	Tax rates to remain at 22-24% going forward
Net profits reported	640	780	639	0%	-18%	1968	2036	3%	
Adjusted profits	561	987	944	68%	-4%	1,716	2,478	44%	Adjusted profits were 5% above expectations

Source: Company Data, BofA Merrill Lynch Research

Export formulations drove 3Q sales growth

Table 2: IPCA - Export formulations split

Rsmn	3QFY11	2QFY12	3QFY12	YoY (%)	QoQ (%)
Branded formulations	424	444	615	45%	39%
Generic formulations	1033	1253	1359	32%	8%
Tender business (anti-malarial)	221	908	925	319%	2%
Total export formulations	1678	2604	2898	73%	11%
Generics					
US	283	410	411	45%	0%
EU	627	711	763	22%	7%
South Africa	49	50	98	100%	96%
Aus/NZ	71	83	86	21%	4%
Total generics	1030	1254	1358	32%	8%
Branded					
CIS	201	185	319	59%	72%
Latam	15	38	48	220%	26%
S E Asia	59	85	57	-3%	-33%
W Africa	105	80	122	16%	53%
Africa (others)	41	56	69	68%	22%
Total branded	420	444	615	46%	38%

Source: Company

Price objective basis & risk

IPCA Labs (XBLAF)

Our PO of Rs375 is based on 14x FY13E EPS of Rs26.8. Our target multiple is at a discount to Indian pharma peers trading at c16x 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 robust earnings growth outlook (16% recurring earnings growth) and improving business mix. Higher upside from Artemether-Lumefantrine tender (WHO) and higher than expected ramp up from Indore SEZ (for US markets) to be key 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	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Aurobindo Pharma	AUNPF	ARBP IN	Arvind Bothra
	Cipla Limited	XCLAF	CIPLA IN	S.Arun
	Divi's Lab	XXQPF	DIVI IN	Arvind Bothra
	Dr Reddy's Lab	DRYBF	DRRD IN	S.Arun
	Dr Reddys Lab-A	RDY	RDY US	S.Arun
	Glenmark Pharm	XVQWF	GNP IN	Arvind Bothra
	IPCA Labs	XBLAF	IPCA IN	Arvind Bothra
	Lupin Limited	LPMCF	LPC IN	S.Arun
UNDERPERFORM				
	BIOCON LTD	BCLTF	BIOS IN	Arvind Bothra
	CADILA HEALTHCAR	CDLHF	CDH IN	Arvind Bothra
	GSK India	GXOLF	GLXO IN	Arvind Bothra
	Ranbaxy Laboratories Limited	XIZZF	RBXY IN	S.Arun

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
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	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

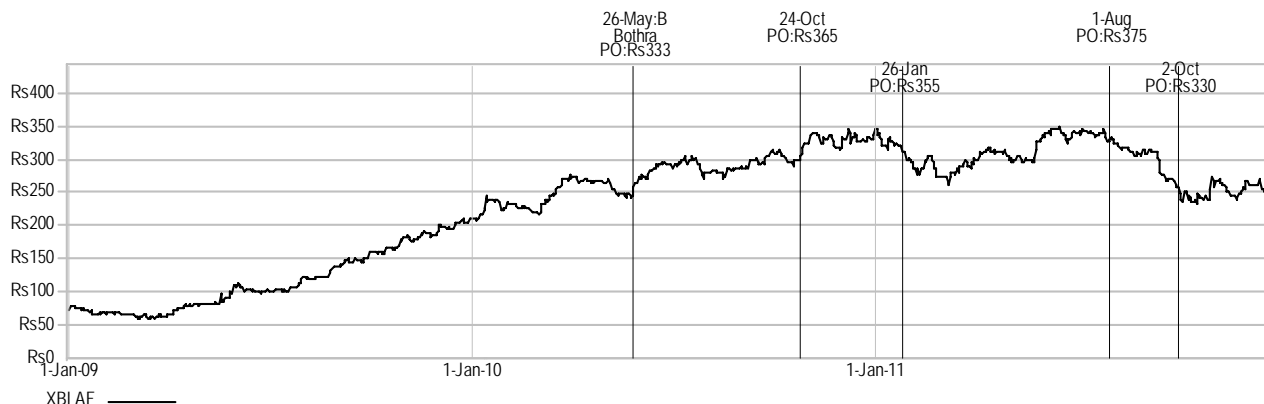
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XBLAF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of [December 31, 2011] or such later date as indicated.

Investment Rating Distribution: Health Care Group (as of 01 Jan 2012)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	154	54.23%	Buy	110	75.86%
Neutral	73	25.70%	Neutral	47	69.12%
Sell	57	20.07%	Sell	30	53.57%

Investment Rating Distribution: Global Group (as of 01 Jan 2012)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2029	52.00%	Buy	1337	72.11%
Neutral	1009	25.86%	Neutral	657	71.34%
Sell	864	22.14%	Sell	487	60.20%

* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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

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