

IPCA LABS (IPCLAB)

Rs 896

WHAT'S CHANGED...

PRICE TARGET	Changed from Rs 694 to Rs 1013
EPS (FY10E)	Unchanged
EPS (FY11E)	Unchanged
RATING.....	Unchanged

Surging ahead...

Ipca Lab's Q2FY10 results were in-line with our estimates but surprised us with 243bps expansion in EBITDA margin against our expectation. Top line grew ~24% YoY to Rs 429 crore on account of ~17% YoY growth in the domestic sales and 32% YoY growth in exports. EBITDA increased by ~24% YoY to Rs 101 crore, however the EBITDA margins remained flat at ~23.5% YoY on account of 24% YoY rise in operating expenditure. Net profit improved by 75% YoY to Rs 64 crore primarily due to forex loss of Rs 24 crore in Q2FY09 charged to the P&L account. Even after excluding the forex impact, net profit grew by ~7% YoY. Overall, we are confident about Ipca's growth momentum and continue to rate the stock as PERFORMER.

Highlights for the quarter

Ipca has entered into a long term supply contract for two APIs with a MNC client, which is expected to ramp up substantially during the year. Growth in the US market has been constrained by the limited capacity in Ipca's Piparia plant. Ipca is working on de-bottlenecking the capacities to increase production. Ipca's branded formulations export business declined sharply by ~35% due to inventory rationalization in CIS and Russia operations. This led the overall EBITDA margin to remain flat at 23.5% YoY despite a sales growth of 24%. The domestic market posted sturdy growth of ~22% YoY to Rs 209 crore (excluding Rs 8 crore government orders executed in Q2FY09).

Valuations

In the domestic market, Ipca already has a good portfolio of offerings. The company is currently witnessing strong traction in the branded formulation business in India and other markets. We expect Ipca's revenue and profits to grow at a CAGR of ~16% and ~51% respectively, through FY11E on account of 16% growth in exports and 21% growth in domestic sales over the same period. We maintain our **PERFORMER** rating on the stock with a target price of Rs 1013, 11x FY11E EPS of Rs 92.

Exhibit 1: Key Financials

	Q2FY10	Q2FY09	Q1FY10	YoY Gr.(%)	QoQ Gr.(%)	YTD FY10
Net Sales	428.8	345.2	357.8	24.2	19.8	786.6
EBITDA	100.6	80.9	70.7	24.4	42.4	171.3
EBITDA Margin (%)	23.5	23.4	19.8	4.1 bps	371.3 bps	21.8
Depreciation	11.7	9.4	11.0	25.1	6.4	22.7
Interest	7.1	7.1	7.6	0.0	-7.3	14.7
Reported PAT	63.9	36.5	49.8	75.0	28.4	113.7
EPS (Rs)	25.6	14.6	19.9			45.5

Source: Company, ICICIdirect.com Research

Rating Matrix

Rating	: Performer
Target	: Rs 1013
Target Period	: 12-15 months
Potential Upside	: 13%

Key Financials

	FY08	FY09	FY10E	FY11E
Net Sales	1051.3	1283.8	1493.7	1722.8
EBITDA	167.8	256.5	309.0	359.6
Net Profit	135.9	100.8	195.3	230.3

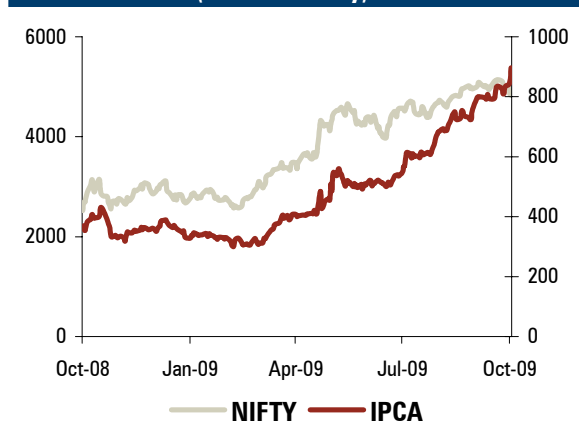
Valuation Summary

	FY08	FY09	FY10E	FY11E
EPS (Rs)	54.4	40.3	78.1	92.1
PE (x)	16.5	22.2	11.5	9.7
Target PE (x)	18.6	25.1	13.0	11.0
EV to EBITDA (x)	15.4	10.5	8.4	7.1
Price to book (x)	3.8	3.5	2.8	2.3
RoNW (%)	23.1	16.0	24.7	23.5
RoCE (%)	15.2	19.6	22.8	22.4

Stock Data

Market Capitalisation	Rs 2240 crore
Debt (FY09)	Rs 460 crore
Cash (FY09)	Rs 11 crore
EV	Rs 2689 crore
52 week H/L	860/285
Equity capital	Rs 25 crore
Face value	10.0
MF Holding (%)	37.1
RI Holding (%)	0.4

Price Movement (Stock vs. Nifty)



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Result Analysis

■ Sales growth in line with expectations

Ipca's topline grew at 24% YoY in Q2FY10 to Rs 429 crore (we expected Rs 423 crore) buoyed by a robust 17% growth in the domestic and 32% growth in exports revenue. During Q2FY10, the domestic business grew strongly by 17% YoY to Rs 209 crore, backed by 14% growth in the fixed dosage business. The company's three main divisions viz. CVS & anti-diabetic, Pain management and Anti-malaria staged growth. Excluding the government order worth Rs 8 crore executed in Q2FY09, the domestic market grew strongly by 22% YoY.

The CVS & anti-diabetic division were driven by extended release formulations of Amlodipine. The pain management and the Rheumatology segment continue to do well. The anti-malarial division grew 19% during H1FY10 in spite of chloroquine recording a subdued growth in Q1FY10. Other division such as the CNS, Dermatology and Gastro-intestinal grew 27%, 56% and 23% respectively during Q2FY10.

On the exports front, the fixed dosage business logged a robust growth of 32%, in spite of inventory rationalization in the branded promotional markets. API exports logged a robust growth of 36% to Rs 82 crore in Q2FY10 on account of good growth in the UK market where the company has backward integrated into its own API's. Growth in the UK market has been encouraging as the region was witnessing lot of price fluctuation in the Amoxy based products during the last few quarters. The US business clocked revenues of Rs 15 crore vis-à-vis Rs 11.6 crore in Q2FY09.

The company has filed 14 abbreviated new drug applications (ANDA's) in the US and has received approval for nine. Another three ANDA's will be filed in the coming months. Ipca currently has only five formulations selling in the US garnering market share in excess of 15%. Ipca is currently facing capacity constraint for its US business. Going ahead, de-bottlenecking and filing ANDA's every year from its Indore SEZ facility will drive the growth in the US market. Ipca expects this facility to get inspected and approved by the FDA over the next 3 quarters. For FY10, the company has guided sales of ~Rs 55 crore from the US (against ~Rs 45 crore earlier).

Exhibit 2: Business Highlights					(Rs Crore)
	Q2FY10	Q2FY09	YoY %	Q1FY10	QoQ %
Domestic	209.25	179.39	16.6	122.15	71.3
% to total sales	49%	52%		39%	
Formulation	171.5	150.1	14.2	92.5	85.4
% to domestic sales	82.0	83.7		75.7	
API	37.8	29.3	29.0	29.7	27.4
% to domestic sales	18.0	16.3		24.3	
Exports	219.5	165.8	32.4	192.9	13.8
% to total sales	51%	48%		61%	
Formulation	137.8	105.8	30.1	130.0	6.0
% to export sales	62.7	63.8		67.4	
API	81.8	60.0	36.4	62.9	30.0
% to export sales	37.3	36.2		32.6	
Sales	428.8	345.2	24.2	315.1	36.1

Source: Company, ICICIdirect.com Research

■ **EBITDA margin flat at ~23.5% YoY, but ahead of our expectations**

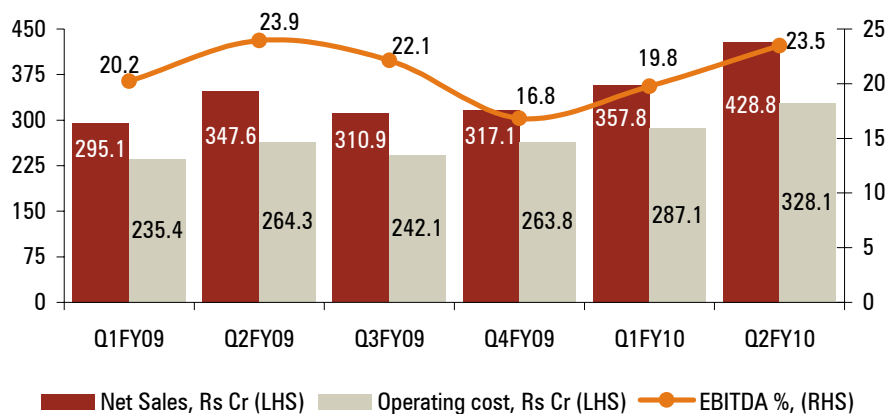
The Q2FY10 EBITDA margin of ~23.5% was above our expectation of 21%. The margins remained flat on a YoY basis on account of lower revenue generation from the promotional export markets of CIS and Russia and higher component of low margin API sales. API contribution increased from 26% in Q2FY09 to 28% in Q2FY10. Lower realisation due to the Sterling pound had a negative impact on operating profitability. However, a decline in employee and other expenses as a percentage of sales prevented further margin erosion. Going ahead, we expect the operating profit to grow at a CAGR of ~18% registering EBITDA margin of 20.3%, through FY11E.

Exhibit 3: Cost Structure (% to net sales)

	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10
Net Sales	100	100	100	100	100
Total Expenditure	76.6	77.9	83.2	80.2	76.5
RM Cost	37.3	38.1	42.4	41.7	40.5
Employee	13.8	14.0	15.6	14.5	13.4
Other expenses	25.5	25.9	25.2	24.1	22.6
EBITDA	23.4	22.1	16.8	19.8	23.5

Source: Company, ICICIdirect.com Research

Exhibit 4: EBITDA margins inching upwards



Source: Company, ICICIdirect.com Research

■ **Higher Net Profit helped by forex impact**

During Q2FY10, net profit margin improved by 432 basis points to 14.9% on account of i) lower interest cost and ii) lower forex volatility. During Q2FY10, IPCA reduced its debt obligation by Rs 41 crore to Rs 435 crore. Margin expansion was also aided by a forex loss of Rs 24 crore which the company had charged to the P&L account in Q2FY09 vis-à-vis loss of Rs 0.6 crore in Q2FY10. Ipca currently has ~50% of its FY10 exports hedged at Rs 48.4/US\$. Further margin expansion was constrained due to higher tax charges on account of changing product mix.

Exhibit 5: Common size profit and loss account

	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10
Net Sales	100	100	100	100	100
Depreciation	2.7	3.3	3.3	3.1	2.7
Interest	2.0	3.7	2.5	2.1	1.6
PBT	12.7	9.8	6.6	17.8	19.4
Tax (% to PBT)	16.5	24.0	0.9	3.8	4.5
Net Profit	10.6	7.5	2.5	13.9	14.9

Source: Company, ICICIdirect.com Research

Valuation

Given the strong traction in the branded business and good growth in the generic business despite the low margin tender business, we believe Ipca is on track to generate robust revenues and net profit growth during FY09-11E. There has been a marked improvement in the API business across markets as reflected in 34% growth during the year. With increasing client ANDAs getting approval, the management is hopeful of maintaining the growth trajectory. Ipca is looking to file 10-12 ANDA's on an annual basis and this run rate is likely to be maintained. In the domestic market, it already has a good portfolio of offerings. The company is planning to venture into the high growth Urology and the Nephrology segments in the near future which will add to the domestic strength. The management has guided for a top-line growth of ~20% and expects the operating margins to hover around 21-22% mark.

Ipca has entered into a long-term contract in Q2FY10 for the supply of two API's which is expected to ramp up substantially during the year. Increasing number of MNC clients are showing interest in outsourcing their late stage products from IPCA. This could further improve the growth prospects in the API business.

We expect Ipca's revenues to grow at a CAGR of 16%, through FY11E on account of 16% growth in exports and 21% growth in domestic sales. We continue to rate the stock as **PERFORMER** with a target price of Rs 1013, 11x FY11E EPS of Rs 92.1 and 7.1x its FY11E EV/EBITDA.

Exhibit 6: Valuation Table

	Sales (Rs Cr)	Sales Gr (%)	EPS (Rs)	EPS Gr (%)	PE (x)	EV/EBIDTA (x)	RoNW (%)	RoCE (%)
FY08	1051.3	14.1	54.4	11.2	16.5	15.4	23.1	15.2
FY09	1283.8	22.1	40.3	-25.8	22.2	10.5	16.0	19.6
FY10E	1493.7	16.3	78.1	93.7	11.5	8.4	24.7	22.8
FY11E	1722.8	15.3	92.1	17.9	9.7	7.1	23.5	22.4

Source: Company, ICICIdirect.com Research

ICICIdirect.com Coverage Universe

Alembic					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E* (x)	RoNW (%)	RoCE (%)
Idirect Code	ALECHE	CMP	47	FY08	1003.2	8.0	5.8	7.2	32.6	19.1
		Target	57	FY09	1116.1	3.4	13.9*	8.8	14.0*	11.3
MCap	647.3	Upside (%)	22	FY10E	1165.7	4.5	10.3	6.4	12.4	11.5
				FY11E	1377.4	7.1	6.6	4.3	16.9	15.5
Biocon					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E* (x)	RoNW (%)	RoCE (%)
Idirect Code	BIOCON	CMP	257	FY08	1108.2	23.2	11.1	8.7	14.8	13.8
		Target	335	FY09	1608.7	12.0	18.2*	17.6	11.4	13.2
MCap	5140.0	Upside (%)	30	FY10E	2430.9	17.6	14.6	10.6	17.0	19.7
				FY11E	2870.1	20.3	12.7	10.9	19.1	23.4
Dishman					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E* (x)	RoNW (%)	RoCE (%)
Idirect Code	DISHPHA	CMP	255	FY08	803.1	14.9	17.1	16.6	21.6	9.7
		Target	325	FY09	1062.4	18.2	14.0	10.5	20.9	13.7
MCap	2057.8	Upside (%)	27	FY10E	1286.9	27.9	9.1	7.7	27.8	17.5
IPCA Labs					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E* (x)	RoNW (%)	RoCE (%)
Idirect Code	IPCLAB	CMP	896	FY08	1051.3	54.4	16.5	15.4	23.1	15.2
		Target	1013	FY09	1283.8	40.3	22.2	10.5	16.0	19.6
MCap	2240.0	Upside (%)	13	FY10E	1493.7	78.1	11.5	8.4	24.7	22.8
				FY11E	1722.8	92.1	9.7	7.1	23.5	22.4
Piramal Healthcare					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E* (x)	RoNW (%)	RoCE (%)
Idirect Code	NICPIR	CMP	388	FY08	2867.5	16.0	24.3	16.1	30.7	24.6
		Target	458	FY09	3281.1	15.1	25.6	16.1	24.0	17.7
MCap	8109.2	Upside (%)	18	FY10E	3510.0	20.5	18.9	13.3	25.9	18.9
				FY11E	3819.7	26.9	14.4	10.4	26.5	22.3
Sun Pharma					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E* (x)	RoNW (%)	RoCE (%)
Idirect Code	SUNPHA	CMP	1366	FY08	3356.7	71.8	19.0	17.4	29.8	30.4
		Target	1344	FY09	4271.4	88.1	15.5	15.1	28.1	28.2
MCap	28292.3	Upside (%)	-2	FY10E	3946.9	68.5	20.0	19.0	18.5	18.9
				FY11E	4468.2	83.2	16.4	15.9	19.0	19.3
Glenmark					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E* (x)	RoNW (%)	RoCE (%)
Idirect Code	GLEPHA	CMP	223	FY08	2037.4	25.4	8.8	7.9	41.7	34.2
		Target	288	FY09	2093.0	7.7	29.1	17.6	19.4	16.4
MCap	5989.7	Upside (%)	29	FY10E	2435.7	14.1	15.8	10.9	16.1	17.3
				FY11E	2827.1	18.0	12.4	8.6	20.2	21.1

Source: Company, ICICIdirect.com Research

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Performer (P): Between 10% and 20%;

Hold (H): $\pm 10\%$ return;

Underperformer (U): -10% or more;

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