1 November 2011

Initiating Coverage | Sector: Healthcare

IPCA Laboratories

Smoother road ahead

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IPCA Laboratories: Smoother road ahead

Page No.

IPCA Laboratories

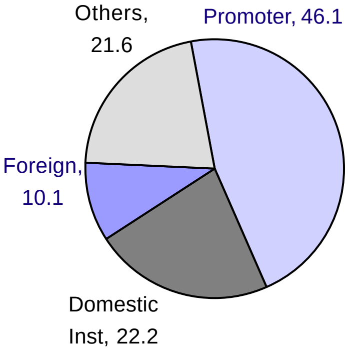
BSE SENSEX	S&P CNX
17,705	5,327

CMP: INR254 **TP: INR378** **Buy**

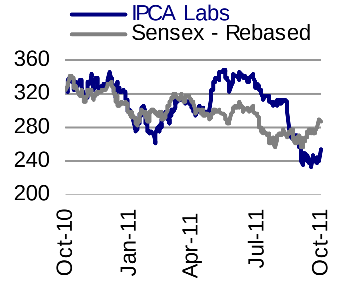
Bloomberg	IPCA IN
Equity Shares (m)	125.7
52-Week Range (INR)	352/225
1,6,12 Rel Perf. (%)	-9/-9/-10
M.Cap. (INR b)	31.9
M.Cap. (USD b)	0.7

Y/E March	2011	2012E	2013E
Revenue (INR b)	19.0	22.3	26.3
Income (INR b)	2.2	2.8	3.4
EPS (INR)	17.4	22.0	27.0
% Chg YoY	9.3	26.4	22.9
P/E (x)	14.6	11.5	9.4
CEPS (INR)	25.3	25.8	33.4
EV/E (x)	9.9	8.1	6.7
Dividend Yield (%)	1.5	1.6	2.1
RoCE (%)	22.7	23.6	24.7
RoE (%)	22.8	24.0	24.4

Shareholding pattern % (Sep-11)



Stock performance (1 year)



Smoother road ahead

APIs, Brands, Capacity expansion

- **One of the better managed mid-cap pharma companies in India with (1) vertically integrated business model, (2) strong domestic formulations business, and (3) profitable international business.**
- **Sharp 30% correction in stock price on short-term headwinds offers lucrative long-term entry opportunity.**
- **Long-term story intact; offers balanced play on growing domestic formulation opportunity and international formulations on the back of strong API capabilities.**

Consistent industry outperformer in domestic formulations: Over FY05-11, IPCA's domestic formulation business clocked revenue CAGR of 22.5%, over 1.5x the industry CAGR of 14%. As a result its market share has improved from 1.18% in FY06 to 1.42% in FY11. IPCA has consistently outperformed the market growth rate on the back of multiple drivers: (1) Growing share of chronic therapeutic segments in revenue mix, (2) Focus on product selection, brand building and new launches, (3) Expansion in the field force, and (4) Proper divisionalization of products. Given all these positives, we expect IPCA to maintain its track record of outperforming the industry growth rate. After a muted 10% growth in FY12, we expect growth to rebound to 18% levels in FY13, translating into FY11-13 CAGR of 14% (v/s 14% for the industry).

APIs offer core competitive advantage of vertical integration: IPCA is one of India's largest manufacturers of APIs, and the global leader in select APIs, with market share of 50%+ coupled with healthy profitability. IPCA is aiming to be world leader in ~25 APIs in the next 3-4 years (15 currently). This augurs well for the company as (1) it offers core competitive advantage of vertical integration benefit, and (2) it creates opportunity to grow revenues beyond captive demand.

Geographic expansion and new Indore SEZ to drive international formulations growth: IPCA has built a strong international formulation business with presence in 110 countries across regulated and emerging markets. This business has two main segments: (1) Branded generics, and (2) Pure generics. We believe IPCA's branded generic business will grow at CAGR of 20-25% over the next two years on the back of (1) Strong sales force, (2) Geographic expansion to South/Central American and Western African countries; and (3) Introduction of new products. The key drivers of pure generics business are: (1) Europe: Geographic expansion beyond UK, (2) US: FDA approval for Indore SEZ, and (3) Africa: Lucrative opportunity in Artemether-Lumefantrine, an anti-malaria formulation.

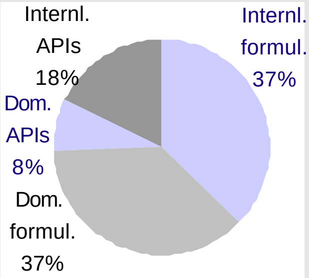
Expect 25% earning CAGR over FY11-13; Initiate with Buy and price target of INR378: We expect IPCA to clock FY11-13 PAT and EPS CAGR of 25% on the back of 18% revenue CAGR coupled with margin expansion. Further, despite INR5b capex to sustain growth, the company is likely to sustain healthy return ratios and low gearing. At 9x FY13 earning, the stock trades at 25-50% discount to its historic and peer valuation. Initiate coverage with **Buy** rating and target price of INR378 (14x FY13E EPS), 50% upside.

One of the better managed mid-sized pharma companies

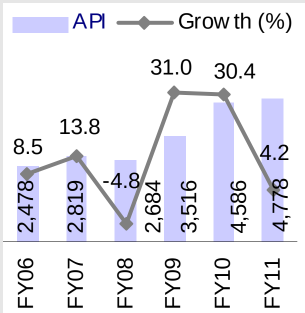
Leveraging core competitive advantage of strong API manufacturing

- Business strategy is to leverage its strength in manufacturing API
- APIs offer core competitive advantage
- Domestic formulations is consistently outperforming the industry
- International formulations - presence across countries

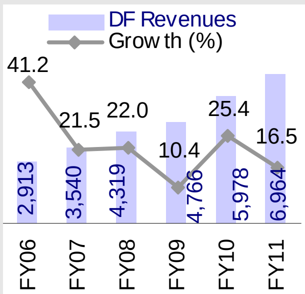
4 segments of IPCA's business model



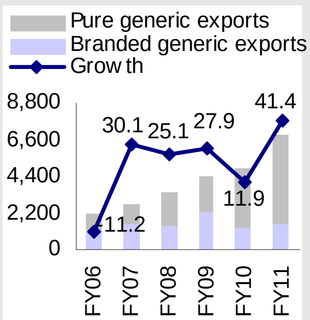
Revenue trend in API



Revenue trend in DF



Revenue trend in international formulation



Established in 1949, IPCA Labs is one of India's better managed mid-sized pharma companies. IPCA has presence in (1) domestic branded formulations, (2) global branded and generic formulations, and (3) global APIs (active pharmaceutical ingredients).

IPCA's core business strategy is to leverage its strength in manufacturing API to develop vertically integrated and highly competitive formulations. Most of the company's formulations are backed by its own APIs.

APIs (26% of FY11 revenue): Core competitive advantage

Strong capability in API manufacturing is at the core of IPCA's business success. IPCA is one of India's largest manufacturers of APIs, and markets them both in the domestic and international markets. The company has attained global leadership position in select APIs where it is the lowest cost producer and largest supplier with market share of 50-70%. The company manufactures APIs mainly in three therapeutic segments: (1) CVS, (2) Pain management, and (3) Anti-malaria.

Domestic formulations (37% of revenue): Consistent outperformance

IPCA has outperformed the industry growth over the past 5 years on the back of its rising presence in fast-growing chronic therapy segments, which contribute ~65% of domestic formulation revenue. It is India's largest player in anti-malaria segment, and is also among the leaders in CVS and Pain management therapeutic segments.

International formulations (37% of revenue): Presence in 110 countries

IPCA has built a strong international formulation business with presence in 110 countries across regulated and emerging markets. This business has two main segments: (1) Pure generics, and (2) Branded generics.

1. **Pure generics:** IPCA has a larger presence in pure generics compared to branded generics. Europe is its largest market followed by US. Here, the company sells its products through distributors and partners.
2. **Branded generics:** IPCA has small presence in this segment, primarily in Asia and CIS countries. Here, it employs its own field force to market its products.

Further IPCA has sizable institutional business through which it supplies anti-malaria drugs primarily to African countries.

Stock correction of 30% in last 4 months offers good entry point

Headwinds are temporary; company to perform well in long term

- **Stock has corrected 30% over last 4 months**
- **Correction was led by disappointing performance in domestic formulation business and consequently guidance downgrade**
- **Headwinds are temporary; long-term business prospects positive**

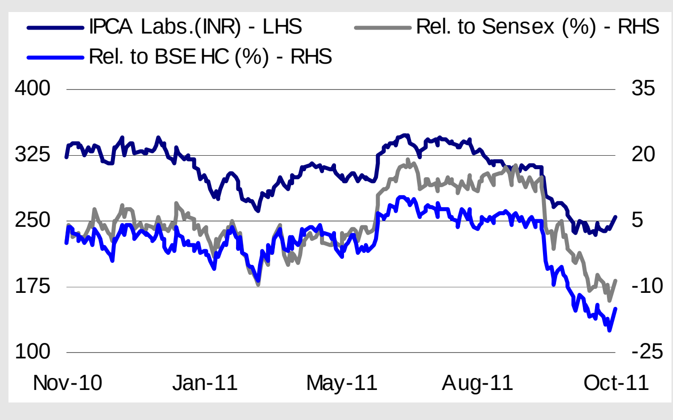
Stock has corrected 30% over last 4 months

IPCA has underperformed Sensex by 20% over the last 4 months. The stock correction offers good opportunity to buy

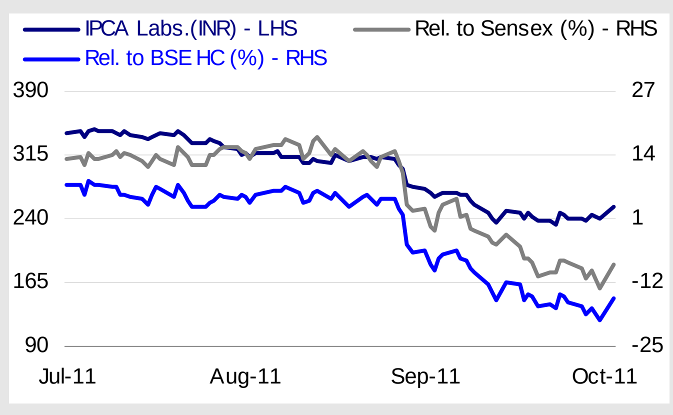
IPCA stock has corrected significantly in the last 4 months. In absolute terms the stock price is down 30% over the last 4 months. On a relative basis, the stock has underperformed Sensex by 20% during the same time. We believe this correction is on the back of a few recent headwinds -

- Lower growth in domestic formulation business
- Muted EBITDA margins guidance
- Likely forex losses due to weak rupee.

IPCA stock had significantly outperformed till June 2011 …



… and then the underperformance began



(Include BSE Healthcare as a 3rd line in both the charts) Source: BSE/MOSL

Headwinds are temporary; long-term business prospects positive

Muted growth of 7% reported in domestic formulation segment in 1HFY12.

We believe headwinds facing the company for last two quarters are temporary in nature:

1) **Lower growth in domestic formulation business:** IPCA has lowered its domestic formulation business FY12 growth guidance from 18-20% to 8-10% recently on account of (1) lower incidence of malaria, infection, etc, and (2) restructuring of CVS and Pain management divisions. We feel these reasons are temporary/one-off, and the company should resume reporting above-industry growth rate from FY13 onwards on account of (1) revival in domestic formulation industry, (2) stabilization of the sales force in IPCA's CVS and Pain management divisions, and (3) improvement in MR productivity.

The company has guided for margin expansion of only 100bps in FY12 on account of slowdown in domestic business and pending USFDA approval for Indore SEZ

2) **Muted EBITDA margin guidance:** IPCA has guided for only 100bp margin expansion in FY12 owing to (1) lower growth in domestic formulation business, and (2) pending USFDA approval for Indore SEZ. We believe FY13 could see strong margin expansion led by (1) rebound in domestic business, and (2) ramp-up in US revenues following USFDA approval.
3) **Forex losses due to weak rupee:** IPCA has forex hedges worth USD140-160m on its books which cover its net P&L exposure for next 18 months. We note that the hedges are at an average USD/INR of 48.3 and unlikely to cause any significant forex losses if USD/INR remains at current level of 49.5. Further, the company has USD90m foreign currency debt on its books. But the risk of forex loss on these loans is naturally hedged by equivalent amount of forex receivables on the balance sheet.

New Pharma Pricing Policy 2011 to have limited impact on the company

The NPPP(2011) unlikely to have significant impact on the business.

The government has released draft of the National Pharmaceuticals Pricing Policy, 2011 (NPPP). Under the policy, all the 348 drugs, which are currently a part of the National List of Essential Medicines (NLEM) will be subjected to price control by the government. Currently only 74 drugs are under price control. The price control will be implemented on the formulations of these drugs as compared to the current practice of controlling bulk drug price. Further, the policy will have market based pricing. The government notified ceiling price (CP) for the formulations covered will be the weighted average price (WAP) of the top three brands (by value) for individual formulations. Pharma companies will have to price their respective formulations either below or at the WAP.

The management mentioned that, under the existing pricing policies followed by the company, it sells the products at a premium pricing in the categories where the company is market leader. In all other categories, the prices of the company's drugs are not at the higher end of the market. So the pricing impact will be felt primarily in Anti-malaria and Rheumatoid Arthritis segment where the company is market leader. However, management has indicated that the overall pricing impact in these therapeutic areas won't be more than 2-3%.

We believe IPCA's long-term prospects remain positive (as discussed in subsequent pages). Thus, the 30% price correction offers a good entry point into the stock.

Growing stronger in lucrative domestic formulation business

Focused strategy; multiple drivers; expect FY11-13 CAGR of 14%

- **Consistently outperforming the industry**
- **Chronic therapies drive growth led by NSAID**
- **Focus on product selection, brand building and new launches**
- **Strong brand equity with doctors in anti-malaria and pain management; improvement in rankings**
- **Expansion in field force; impact to kick in going forward**

IPCA, traditionally an anti-malaria company, has shown strong growth in domestic formulation business over the past few years

IPCA, traditionally an anti-malaria company, has shown strong growth in domestic formulation business over the past few years albeit on a small base. The company has grown this business at CAGR of 22.5% over FY05-11 versus industry growth of just 14%. Apart from growing in size, depth and breadth, the quality of business has also improved. The company has been continuously increasing share of chronic segments in its business mix over the years. The company has also demonstrated strong brand building capabilities with 4 of its brands featuring among top 300 brands in the industry. We expect the company to grow this business at 14% CAGR over FY11-13 (despite near term headwinds) led by expansion in field force, improving field force productivity, brand building exercise, new product launches and entry into new therapeutic areas.

Consistently outperforming the industry

Over FY05-11, IPCA's domestic formulation business clocked revenue CAGR of 22.5%, over 1.5x the industry CAGR of 14%

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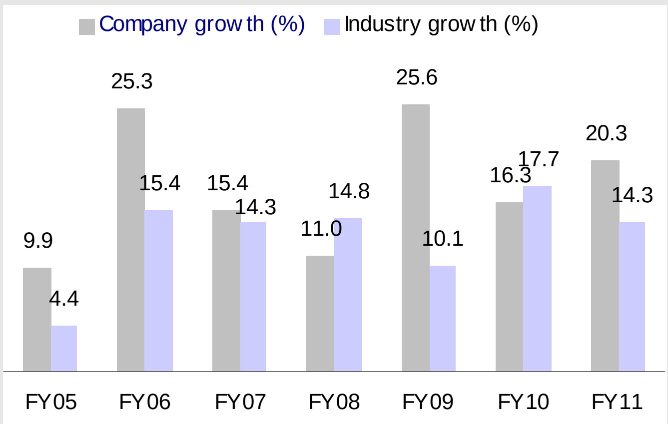
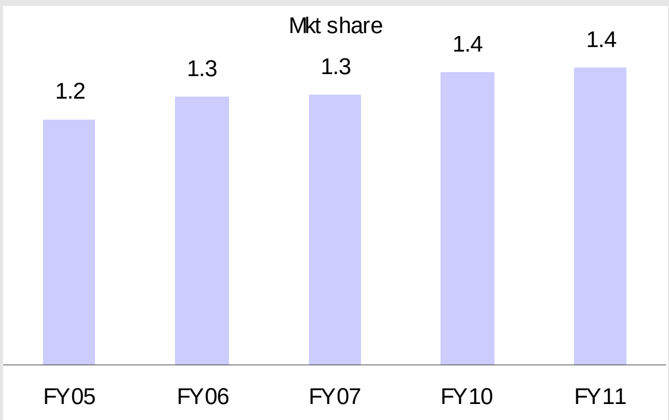
- Growing share of chronic therapeutic segments in revenue mix
- Focus on product selection, brand building and new launches
- Expansion in the field force and
- Proper divisionalization of products.

IPCA has outperformed industry in most years over FY06-11…



… leading to market share expanding from 1.18% to 1.42%



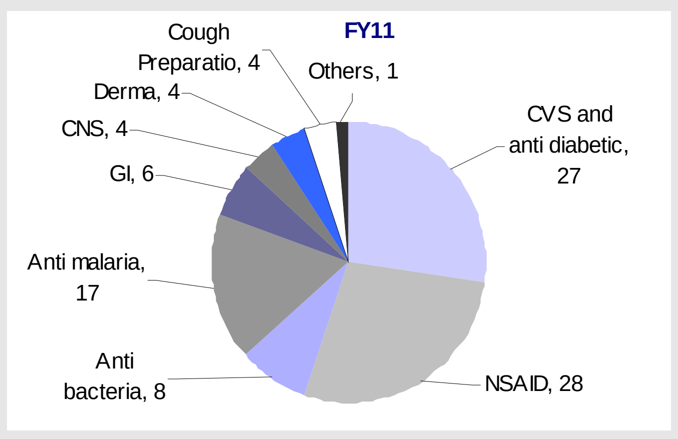
Source: Company/Industry/MOSL

Chronic therapies and NSAID drive growth

Over time, IPCA has managed to sharply lower its dependence on acute therapy segments

Over time, IPCA has managed to sharply lower its dependence on acute therapy segments, viz, anti-malaria, anti-bacteria, gastro-intestinal and others. The combined share of acute therapy segments is down from 51% of revenue in FY06 to 38% in FY11. Consequently, revenues under DPCO coverage reduced from as high as 50% in FY02 to ~10% in FY11. The rise in share of chronic therapeutic segments and strong market share gain in NSAID (non-steroidal anti-inflammatory drugs) segment led to the overall growth.

Chronic therapy areas contribute 62% to the revenues



DF therapeutic contribution (%)

<table>
<tr><th></th><th>FY07</th><th>FY08</th><th>FY09</th><th>FY10</th><th>FY11</th></tr>
<tr><td>CVS and anti diabetic</td><td>27</td><td>28</td><td>29</td><td>28</td><td>27</td></tr>
<tr><td>NSAID</td><td>20</td><td>23</td><td>24</td><td>26</td><td>28</td></tr>
<tr><td>Anti bacteria</td><td>12</td><td>11</td><td>10</td><td>9</td><td>8</td></tr>
<tr><td>Anti malaria</td><td>22</td><td>17</td><td>17</td><td>17</td><td>17</td></tr>
<tr><td>GI</td><td>7</td><td>8</td><td>7</td><td>7</td><td>6</td></tr>
<tr><td>CNS</td><td rowspan="2">6</td><td rowspan="2">7</td><td rowspan="2">7</td><td>4</td><td>4</td></tr>
<tr><td>Derma</td><td>4</td><td>4</td></tr>
<tr><td>Cough Preparatio</td><td>4</td><td>3</td><td>4</td><td>4</td><td>4</td></tr>
<tr><td>Others</td><td>2</td><td>3</td><td>2</td><td>1</td><td>1</td></tr>
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Source: Company/MOSL

Focus on product selection, brand building and new launches

One of the key success factors for IPCA in domestic formulations business has been its product selection and brand building approach

One of the key success factors for IPCA in domestic formulations business has been its product selection and brand building approach. The company carefully chooses products with high growth potential. Also it has been the first one to launch few new molecules in the market, gaining significant traction in those products.

Key products launched in recent years

	Molecule	Brand	Comment
1	Aceclofenac	Zerodol	Today it is a INR800m brand for the company
2	Hydroxy Chloroquine Sulphate	'HCQS'	Has again emerged as one of the key growth drivers for the company over the years
3	Quetiapine	Quel SR	NDDS based products
4	Metoprolol Succinate and Amlodipine	Revelol AM	Sustained release combination formulation
5	Ceftazidime & Sulbactum	GARDCEF	A novel injectable anti-biotic combination

Source: Company/MOSL

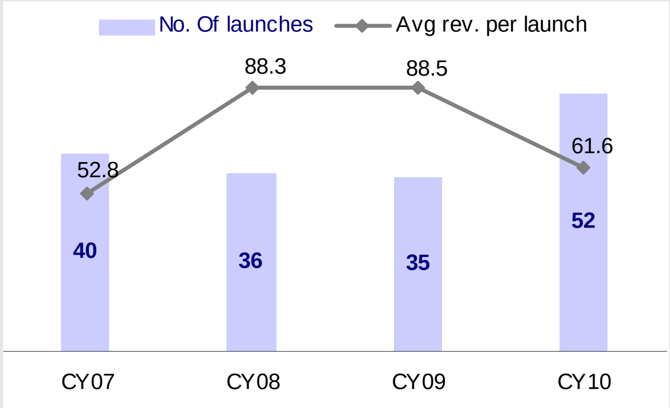
The company has guided to maintain steady rate of 15-25 new product launches every year for the next few years.

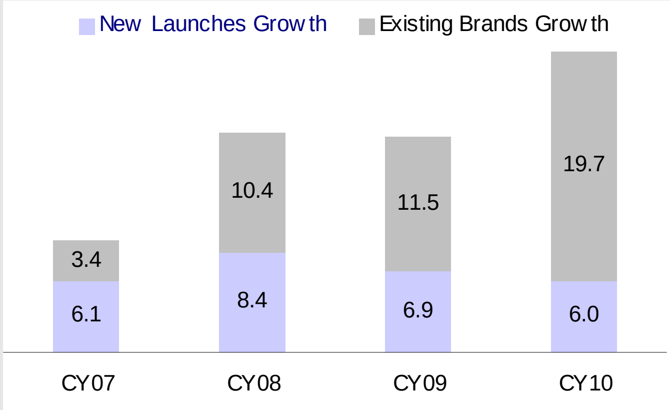
Modest but steady rate of product introductions: IPCA's new product launch rate has been moderate compared to industry peers. In the last four years, it has launched 22 new products annually (including line extensions). The company has guided to maintain steady rate of 15-25 new product launches every year for the next few years.

Brand strategy paying off: IPCA's strategy of launching fewer products compared to peers but making good and sustainable brands out of them has paid off well. IPCA's strong branding strategy is evident from the fact that products launched in last three financial years have contributed upwards of 15% to total domestic formulation revenues.

IPCA has just 150 brands in the market which is very low compared to peers; but still, it has 4 brands among top 300 brands of the industry (up from two brands three years ago).

Moderate in number but highly successful product launches… … contribute 6-8% to revenue growth





Source: Industry/MOSL

Strong brand equity with doctors in anti-malaria and pain management; improvement in rankings

In anti-malaria, IPCA ranks No1 with prescription market share of 43% while in pain management, it ranks No7 with prescription market share of 3.3%

IPCA enjoys strong brand equity in anti-malaria and pain management segments. In anti-malaria, IPCA ranks No1 with prescription market share of 43% while in pain management, it ranks No7 with prescription market share of 3.3% which has improved from 2.5% four years ago. In anti-diabetics, the company has improved its ranking from 15 in Jan-2007 (2.2% share) to 12 in Oct-2010 (2.5% share). Even in other therapy areas like CVS, IPCA has been able to maintain its prescription market share or ranking despite growing competition.

IPCA has maintained its prescription market share and ranking in various therapy segments

PMS*/Rank	Anti-malaria	Pain management	CVS	AD
1QCY07	41.2/1	2.5/11	2.5/15	2.2/15
1QCY08	36.3/1	2.6/11	2.5/14	1.9/19
1QCY09	37.4/1	2.6/12	2.3/15	1.9/16
1QCY10	42.5/1	3.0/10	2.4/14	2.4/11
4QCY10	42.7/1	3.3/7	2.2/16	2.5/12

* Prescription market share

Source: Industry/MOSL

Expansion in field force; impact to kick in going forward

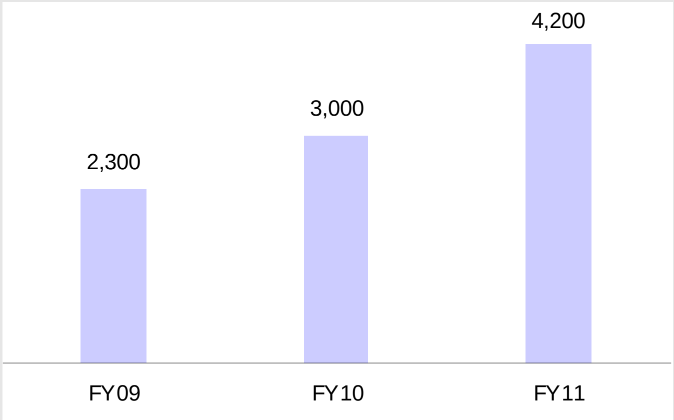
IPCA has doubled its field force over the last three years. It employs one of the largest field forces in the industry with MR strength of 4,200

IPCA has doubled its field force over the last three years. It employs one of the largest field forces in the industry with MR strength of 4,200. We feel the impact of this field force addition is yet to reflect in the revenue, and will help maintain strong growth momentum over the next 4-5 years.

IPCA has already increased its doctor coverage from 200,000 doctors three years ago to 400,000

Further, the company does not plan to increase the field force going forward. Instead, it plans to focus on improving field force productivity, which is very low compared to its large peers. IPCA has already increased its doctor coverage from 200,000 doctors three years ago to 400,000. We believe the company has ample scope to leverage the strong field force to penetrate deeper into the markets.

IPCA has doubled its field force in last 3 years…



…but its MR productivity is still much below that of large players

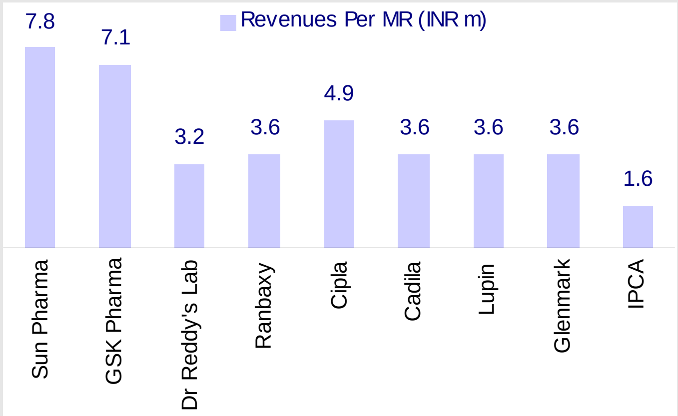


Chart on MR trend

Source: Company/Industry/MOSL

Proper divisionalization of products ensures focus

IPCA has created a robust marketing set-up with 13 marketing divisions. These different divisions focus on different therapeutic segments

IPCA has created a robust marketing set-up with 13 marketing divisions. These different divisions focus on different therapeutic segments and channelize the efforts of MRs who are divided into these divisions. Unlike many other companies, IPCA has limited number of doctors in each MR's list in order to ensure high visit frequency and quality relationship through innovative customer relationship management (CRM) strategies. We believe that this focused approach has worked successfully for the company, as reflected in its rising prescription share in most ailment segments.

Marketing divisions

Division Name	Year	Focus therapeutic classes
General Pharma	1976	CVS, Malaria, NSAID, cough prep
Intima	2002	Malaria, Anti-bacterial, GI
Activa	2003	Ortho, GI
3C	1997	CVS and Anti-diabetics
Innova	2001	CNS
Hycare	2004	CVS and Anti-diabetics
Bionova	Apr-06	Derma
Altus	Apr-07	Anti-biotic
3D	Apr-10	CVS
Nephro Sciences	Apr-10	Nephrology
Urosciences	Apr-10	Urology

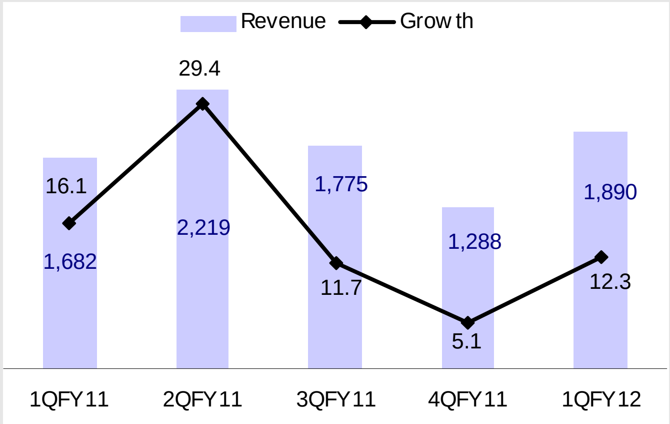
Source: Company/MOSL

Expect 14% revenue CAGR over FY11-13

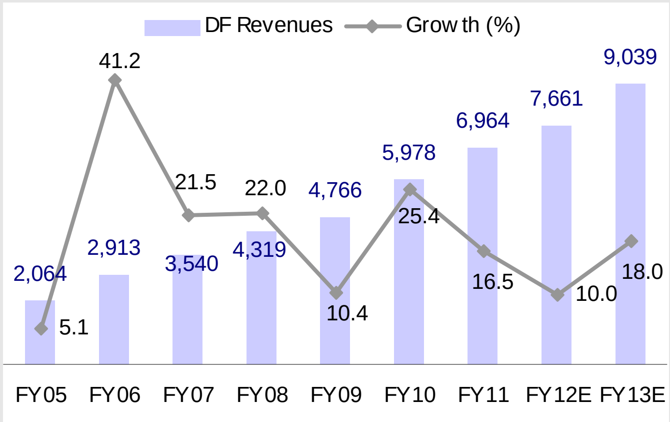
IPCA to maintain its track record of outperforming the industry growth rate

Given all the positives discussed above, we expect IPCA to maintain its track record of outperforming the industry growth rate. After a muted 11% growth in FY12, we expect growth to rebound to 20% levels in FY13, translating into FY11-13 CAGR of 14%.

Temporary headwinds impacted domestic performance



Expect IPCA's industry outperformance to continue



Source: Company/MOSL

API: Core component of IPCA's business model

Provides vertical integration; growth beyond captive demand from FY13

- **Focus on cost competency and market leadership**
- **Benefit of vertical integration**
- **Expect healthy growth from FY13**

IPCA is one of India's largest API producers. IPCA's expanding API basket augurs well for the company in terms of vertical integration benefit and growing revenues beyond captive demand.

Focus on cost competency and market leadership

IPCA always strived to establish itself as the lowest cost global market leader in select APIs, and the strategy has paid off well. IPCA is the lowest cost and the largest producer of 15 APIs globally. This number is up from 10 about four years ago, and is expected to reach 25 over next 3-4 years. It enjoys 50-70% market share in these APIs. Further, unlike some of its peers, the company has been making good margins in this business.

Key APIs

Furosemide
Chlroquine Phosphate
Losartan
Atenolol
Hydrochlorothiazide
Metoclopramide HCl
Hydroxychloroquine Sulphate
Metorprolol Succinate
Pyrantel Pamoate
Propranolol HCl
Metoprolol Tartrate

Source: Company/MOSL

Benefit of vertical integration

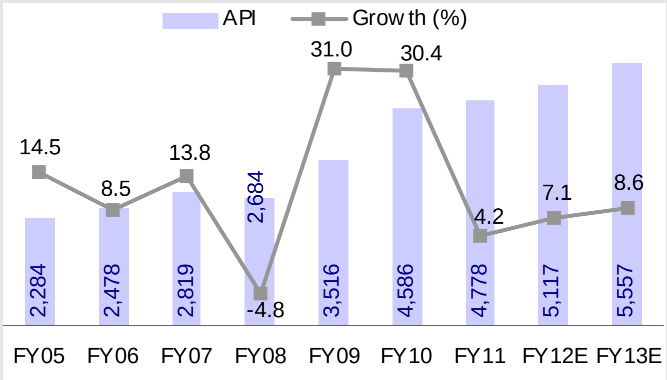
IPCA's cost leadership in its select APIs creates its core competitive advantage of vertical integration in the formulation business. This is most relevant in the pure generics business where product cost is the key success factor. This is evident from the fact that despite being a late entrant in the US, IPCA has managed decent market share coupled with healthy profitability in its products launched so far. On the back of cost competitiveness, IPCA has become a partner of choice for many formulation companies across the globe. It is evident from IPCA's cumulative DMF fillings with USFDA (up from 22 in FY05 to 57 in FY11) and API filings in Europe (up from 7 in FY05 to 29 in FY10).

Expect healthy growth from FY13

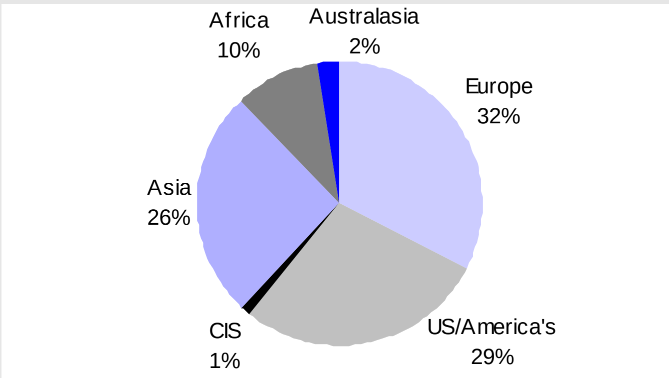
Expect healthy revenue growth in this business from FY13, supported by increasing number of products where IPCA has cost advantage

We expect healthy revenue growth in this business from FY13, supported by increasing number of products where IPCA has cost advantage. Further, many global players have re-filed their products changing their API source to IPCA. The business has clocked 13% CAGR over FY05-11. However, FY11 API revenue growth was muted at 4% despite ~20% increase in production, given higher captive demand. With increase in capacities going forward, we model in API revenue CAGR of 8% over FY11-13.

API growth to resume after muted 4% in FY11



API's market mix is well-diversified



Source: Company/MOSL

International formulations: Expect 20-25% CAGR in branded generics

USFDA approval for Indore SEZ is key for pure generics ramp-up

- **Branded formulations - key growth driver**
- **Europe: Strong product pipeline, vertical integration and geographic expansion to drive growth**
- **US: Significant advantage despite late entry; Indore SEZ approval likely in CY11**

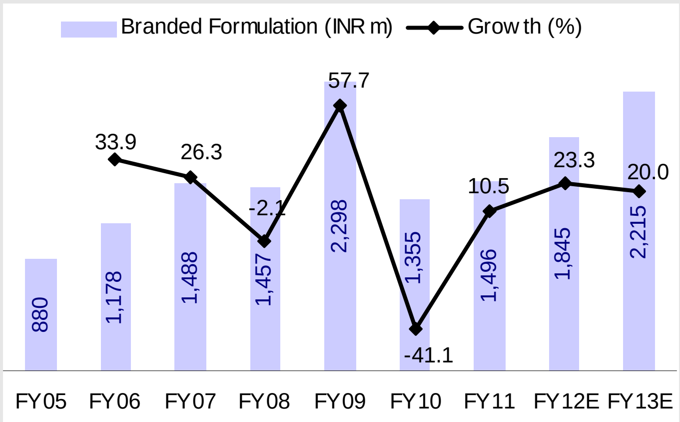
IPCA has comparatively small presence in international formulation segment in terms of revenues compared to some of its peers. However, it has wide reach as it markets its products in 110 countries. IPCA has established its presence in both branded generic markets (with its own field force) and pure generic market (through partners, distributors).

Branded formulations - key growth driver

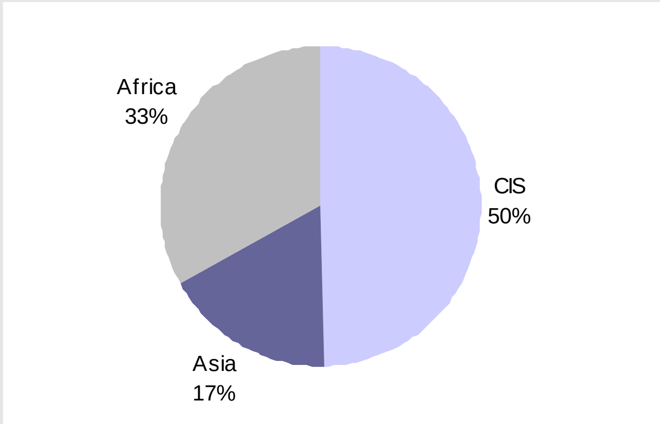
Branded formulations is one of the most profitable businesses for IPCA

Though small in size, branded formulations is one of the most profitable businesses for IPCA with gross margins of 70-75% and EBITDA margins of 27-28%. This segment contributed INR1.6b (8%) to IPCA's total revenues in FY11. Over the years, IPCA has been investing resources in growing its international branded business.

Trend in branded formulations revenue



CIS contributes 50% to branded formulation business



Source: Company/MOSL

Strong sales force of 500

In 40 branded generic markets, IPCA has a sales force of 500 people, which is one of the highest among Indian pharma companies. It has registered formulation dossiers in 70 countries. The company's thrust is on brand-building in pain management, CVS, CNS, anti-infective and anti-malaria segments.

Major markets for the company include CIS, Africa and Asia

CIS remains the largest branded generic market for the company

- CIS remains the largest branded generic market for the company with revenues of INR750m in FY11. Among CIS, IPCA's major markets are Russia, Ukraine and Belarus. The company has ~300 MRs employed in this region. The company's product portfolio is dominated by fast growing CVS therapeutic segment.

- Similarly, in Africa the company sells its products in ~40 countries with field force of ~150.
- In Asia, it has presence in Middle East and South east countries. The expansion of product portfolio would be a key growth driver in these markets for the company.

Expect 20-25% CAGR

We believe that the IPCA's branded generic business will grow at CAGR of 20-25%

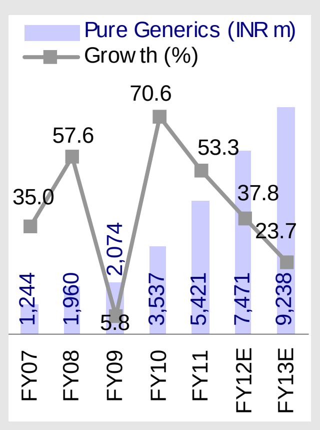
We believe that the IPCA's branded generic business will grow at CAGR of 20-25% over the next two years on the back of:

- Strong sales force;
- Geographic expansion to South and Central American and Western African countries; and
- Introduction of new products (IPCA has identified 50 existing formulations for registration and launch across geographies).

Pure generics - USFDA approval for Indore SEZ is key to ramp-up

IPCA derives 29% of its revenue from pure generics exported to Europe, US, Australasia and Africa. Europe is the largest generic market for IPCA, of which 90% of revenue comes from UK alone. This is followed by Africa where the company sells anti-malaria drugs through various institutions. IPCA is a late entrant in the US markets having started business here as recent as in FY09. Australasia is a highly profitable market for IPCA, but revenues from this market are low as of now.

Trend in pure generics revenue



Source: Company/MOSL

The key drivers of pure generics business are -

- **Europe:** Geographic expansion beyond UK
- **US:** US FDA approval for Indore SEZ
- **Africa:** Lucrative opportunity in Artemether-Lumefantrine, an anti-malaria formulation.

Europe: Strong product pipeline, vertical integration and geographic expansion to drive growth

Unlike in the past, when IPCA used to market plain vanilla generic products based on dossiers purchased from other companies, IPCA's product portfolio now consists of complex products. This gives it an edge in the highly competitive UK market. Further, the company has developed a large product basket with 38 products already registered and 16 products under registration in UK and other European countries like Portugal. Importantly, most of these products are backed by its own API which offers the company good profitability despite very high pricing pressure. Also the company has started diversifying its presence in other European countries to reduce its dependence on UK. In a few geographies, IPCA is also selling the product dossiers to other companies against milestone payments and long-term supply arrangements.

Product registered and under registration over the years

UK	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Dossier filed	32	36	39	44	45	45	47
Dossier registered	6	12	21	29	27	29	35

Source: Company/MOSL

US: Significant advantage despite late entry; Indore SEZ approval likely in CY11

The company has so far filed 22 ANDAs and has received approval for 12, of which it has launched 7 products

Though IPCA is a late entrant in US, it has demonstrated ability to scale up the business rapidly. Within three years of its entry in the US, IPCA earns revenue of ~USD25m in this market. Here, IPCA has adopted the partnership model rather than marketing on its own. It has three partners, Ranbaxy being the largest. It has tied up with Ranbaxy for supply of 25 ANDAs for which IPCA supplies the final product with manufacturing margins. Further, IPCA and Ranbaxy equally share the profits generated through selling the products. The company has so far filed 22 ANDAs and has received approval for 12, of which it has launched 7 products so far. IPCA intends to file 10-12 ANDAs every year for next few years.

Approved ANDAs

	Filed	Approved
FY07	8	2
FY08	10	5
FY09	11	9
FY10	16	10
FY11	22	12

Source: Company/MOSL

We like the company's strategy to focus on select products where it has vertical integration advantage. It will enable the company to garner higher market share in various products launched. We believe US will be a key long-term growth driver for the company. However in the near term, early USFDA approval for Indore SEZ is key to ramp up revenues in US. Currently, IPCA has only one USFDA formulation facility at Silvassa which is running at full capacity. The company has invested INR1.5b in construction of new SEZ at Indore which is built specifically for the US market. The facility is awaiting USFDA approval for last 2 years and is expected to finally receive the same in CY11. Once approved, this facility can generate peak revenues of USD100m for IPCA. We have modeled in revenue from Indore SEZ beginning FY13.

Africa: Anti-malarial formulation presents significant revenue ramp-up potential

IPCA has obtained WHO pre-qualification for Artemether-Lumefantrine, an anti-malaria formulation. This is a USD400m market with only 3 other players

IPCA has obtained WHO pre-qualification for Artemether-Lumefantrine, an anti-malaria formulation. This is a USD400m market with only 3 other players. This is a lucrative product opportunity with significantly high EBITDA margins at ~32%. We note that IPCA is the only fully integrated player hence enjoys significant advantage over other players in terms of ramping up the business. Currently Novartis has the largest share in the institutional tender business for the product. IPCA's revenue from this product has increased from INR300m in FY10 to INR1.2b in FY11. We are very positive on IPCA's prospects in this opportunity and believe that IPCA will manage to garner much higher market share going forward. We expect revenues of INR2.5b from this business in FY12 and INR3b in FY13.

Expect 18% revenue CAGR, 25% EPS CAGR

Operating leverage to drive earnings growth; return rations sustainable

- **Branded formulations and institutional business to drive 18% revenue CAGR**
- **EBITDA to grow at 22.5% CAGR; Margin improvement to sustain**
- **EPS CAGR of 25% led by strong operating performance and lower tax expense**
- **INR5b capex planned to support revenue scale-up**
- **Strong returns ratios to sustain despite large capex**

Expect IPCA to clock topline CAGR of 18% over FY11-13 led by branded formulations, both in the domestic and international markets

We expect IPCA to clock topline CAGR of 18% over FY11-13 led by branded formulations, both in the domestic and international markets. Margins would expand 170bp over this period led by higher capacity utilization and improving product mix, in turn, driving PAT and EPS CAGR of 25%. Further, we expect strong return ratios to sustain going forward despite high capex of INR5b planned over next two years.

Branded formulations and institutional business to drive 18% revenue CAGR

We expect IPCA to report revenue CAGR of 18% over FY11-13 led by strong traction in domestic formulation segment (14% CAGR), branded formulation exports (22% CAGR) and institutional business (57% CAGR). We expect back-ended growth for regulated markets like US and Europe due to slowdown in Europe and capacity constraints for US market. API segment is expected to grow at 8% led by new product launches.

Topline growth led by branded formulation institutional business and US market

Branded formulations to drive revenue growth

	FY08	FY09	FY10	FY11	FY12E	FY13E	FY11-13 CAGR (%)
Domestic formulation	**4,319**	**4,766**	**5,978**	**6,964**	**7,661**	**9,039**	**13.9**
YoY Growth (%)	22.0	10.4	25.4	16.5	10.0	18.0	
International formulation	**3,417**	**4,372**	**4,892**	**6,917**	**9,317**	**11,453**	**28.7**
YoY Growth (%)	25.1	27.9	11.9	41.4	34.7	22.9	
Europe	1,873	1,741	2,483	2,800	3,220	3,542	12.5
America's	31	242	664	1,159	1,449	2,318	41.4
Australasia	55	90	120	242	303	378	25.0
CIS	557	1,023	658	742	927	1,113	22.5
Asia	204	177	173	258	323	387	22.5
Africa	696	1,099	524	496	595	714	20.0
Institutional business	0	0	270	1220	2500	3000	56.8
Domestic APIs	**741**	**1,083**	**1,416**	**1,443**	**1,515**	**1,667**	**7.5**
YoY Growth (%)	4.9	46.2	30.7	1.9	5.0	10.0	
International APIs	**1,943**	**2,432**	**3,169**	**3,335**	**3,601**	**3,890**	**8.0**
YoY Growth (%)	-8.0	25.2	30.3	5.2	8.0	8.0	
Net Sales	**10,419**	**12,653**	**15,456**	**18,659**	**22,094**	**26,049**	**18.2**
YoY Growth (%)	14.6	21.4	22.1	20.7	18.4	17.9	
Other operating income	**139**	**88**	**70**	**163**	**196**	**235**	**20.0**
YoY Growth (%)	16.5	-36.6	-20.5	132.1	20.0	20.0	
Income from operations	**10,559**	**12,742**	**15,526**	**18,822**	**22,290**	**26,284**	**18.2**
YoY Growth (%)	14.6	20.7	21.9	21.2	18.4	17.9	

Source: Company/MOSL

EBITDA to grow at 22.5% CAGR; Margin improvement to sustain

FY12 margins are likely to remain under pressure

We expect FY11-13 EBITDA CAGR of 22.5% on the back of strong revenue growth and improvement in the margins. FY12 margins are likely to remain under pressure owing to:

1) Muted growth in domestic formulation revenues;
2) Higher spend in domestic formulation segment due to (a) increased field force, (b) entry into newer therapeutic segments, and (c) start-up cost of Sikkim facility; and
3) Fixed costs at Indore SEZ without commensurate revenues, pending USFDA approval (we expect revenues to start only in FY13).

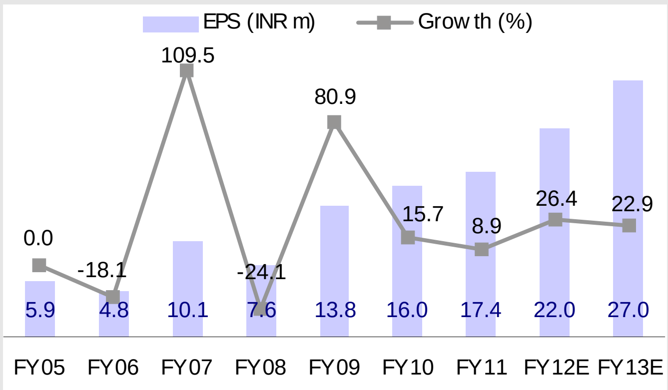
We expect margin improvement from FY13 with (1) normalcy in domestic formulation business, and (2) revenue contribution from Indore SEZ. Historically, IPCA has steadily improved EBITDA margin from 14.8% in FY06 to 19.8% in FY11.

EPS CAGR of 25% led by strong operating performance and lower tax expense

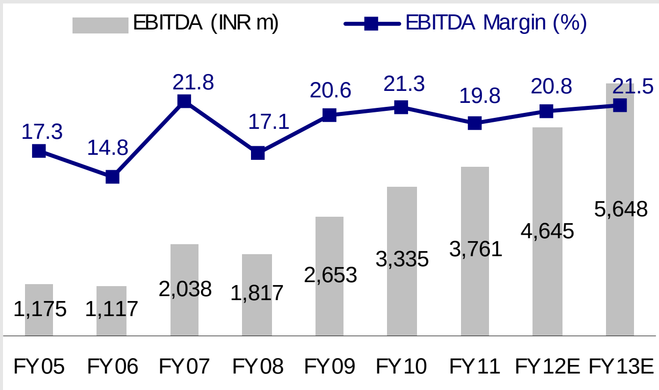
IPCA's earnings are likely to grow at 25% CAGR over FY11-13, in-line led by strong operating performance

IPCA's earnings are likely to grow at 25% CAGR over FY11-13, in-line led by strong operating performance. We feel that the interest will remain stagnant with stable debt level. However we expect tax rate to come down owning to commencement of Sikkim facility in this month for domestic formulation business and Indore SEZ being taken under MAT. Over the last seven years the earnings have gone up at CAGR of 20%

Earnings growth to accelerate FY13 onwards…



…in line with higher EBITDA and EBITDA margins



Source: Company/MOSL

INR5b capex planned to support revenue scale-up

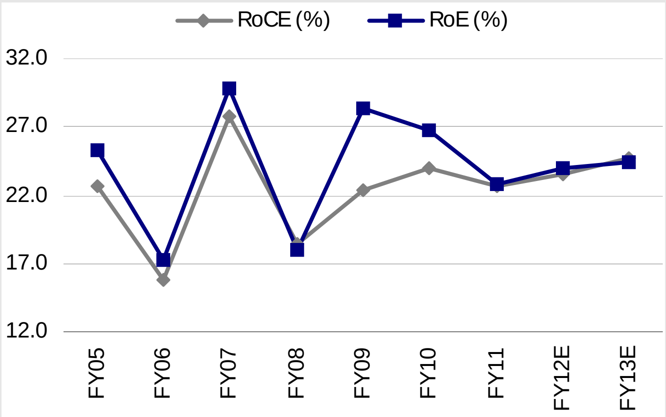
IPCA expects to spend ~INR5b over FY12 and FY13 to increase capacities in sync with the strong traction in revenue. The company is planning a greenfield manufacturing facility at Baroda and likely to expand its API capacities at various locations. Besides, INR500m would be invested in Indore SEZ and Sikkim facility before they start commercial production.

Strong returns ratios to sustain despite large capex

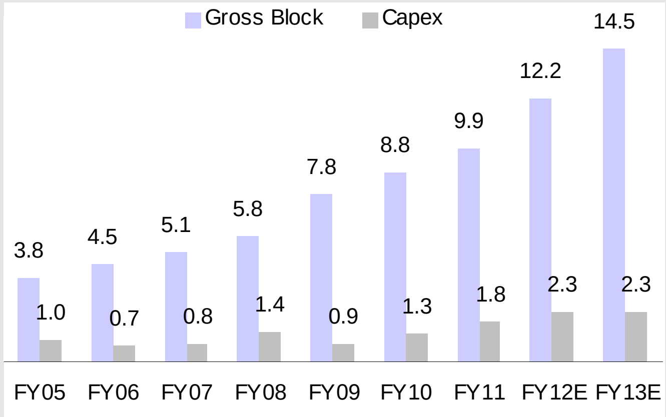
IPCA's return ratios have improved remarkably over the years

IPCA's return ratios have improved remarkably over the years - RoCE up from 17.2% in FY06 to ~23% in FY11, and RoE up from 15.9% to ~23% over the same period. Our estimates suggest that despite the INR5b capex, IPCA will sustain its high return ratios on the back of improving profitability driven by higher asset utilization and operating leverage.

Impressive return ratios to sustain…



…despite strong capex to support revenue scale-up (INR b)



Source: Company/MOSL

1HFY12 performance review: Robust growth despite slowdown in domestic business

- IPCA achieved robust growth in both revenue and profits during first half of FY12. Revenue was up 23.2%YoY to INR11.5b. EBITDA grew 33.8%YoY to INR2.53b while adjusted PAT grew 47.4%YoY to INR1.58b.
- Topline growth was driven by 57.2%YoY growth in export formulation to INR4.67b on the back of ~5x increase in institutional business led by anti-malaria segment and ~60% growth in US market albeit on a low base. Domestic formulation business reported muted growth of 7.2%YoY to INR4.18b during the period due to 1) lower revenue in anti-malaria and anti-bacterial segments, 2) restructuring of various marketing divisions 3) attrition in field force and 4) overall slowdown in the industry.
- API revenue reported muted growth of 7.3%YoY to INR2.59b primarily due to increase in captive consumption to support increase in demand in formulation segment. During 1HFY12, the company could not sell Artemether API outside due to increased captive consumption.
- EBITDA grew 33.8%YoY to INR2.53b while EBITDA margins expanded 177bp to 21.3%. The margins expansion came on the back of favorable product mix as the share of high margin business segments going up.
- Adjusted PAT grew by 47.4%YoY to INR1.58b led by strong operational performance and lower tax expense.

Buy with target price of INR378, 50% upside

Trading at discount to historical and peers valuation

- **Vertically integrated business model with core competitive advantage of APIs**
- **De-risked revenue streams, both in terms of product lines and geographies**
- **25% EPS CAGR: We expect the company to report earning CAGR of 25% over FY11-13 on the back of strong revenue growth and margin expansion.**
- **We initiate coverage with a Buy rating and target price of INR378 (14x FY13E EPS), a 50% upside.**

Key qualitative arguments

We believe IPCA is one of the best managed mid-sized pharma company in India. Our key qualitative arguments are:

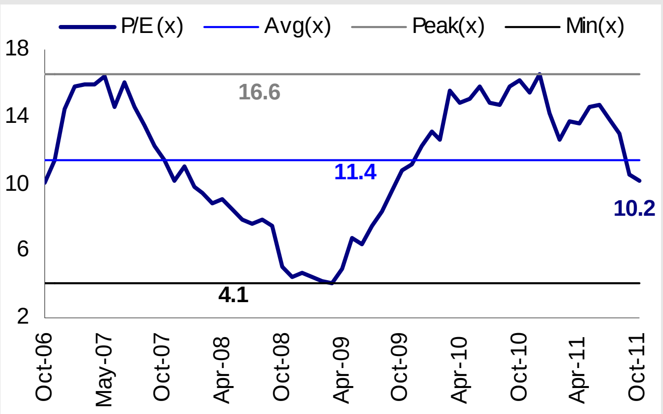
√ Vertically integrated business model with core competitive advantage of APIs;
√ De-risked revenue streams, both in terms of product lines and geographies;
√ Solid business strategy around branded formulations; and
√ Conservative, yet proactive, management.

Key financial and valuation arguments

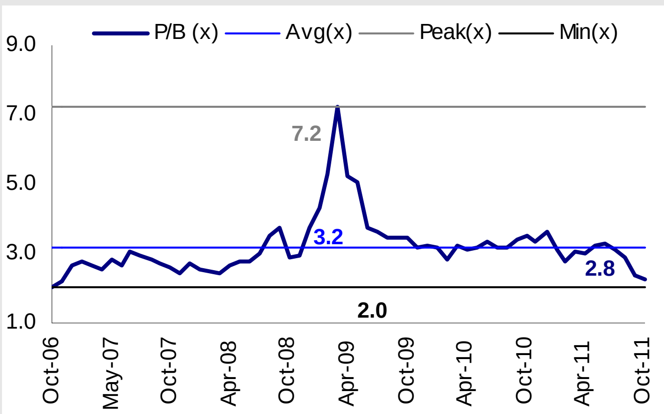
√ **25% EPS CAGR:** We expect the company to report earning CAGR of 25% over FY11-13 on the back of strong revenue growth and margin expansion.
√ High return ratios, low gearing: The company is likely to sustain healthy return ratios going forward; gearing is low and expected to fall further (FY13E D/E at 0.50 v/s 0.53 in FY11).
√ Significant valuation discount: At 9x FY13 earning, the IPCA stock trades at 25-50% discount to its own historic valuation and that of peers.
√ **Buy for 50% upside:** We initiate coverage with a **Buy** rating and target price of INR378 (14x FY13E EPS), a 50% upside.

Historical valuation bands

One year forward P/E



One year forward P/BV



Source: MOSL

IPCA: Peer valuations

Company	CMP	EPS (INR)			P/E (x)			EV/EBITDA (x)			RoE (%)		
	(INR)	FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY11	FY12E	FY13E
IPCA Labs	254	17.4	22.0	27.0	14.6	11.6	9.4	9.9	8.1	6.7	22.8	24.0	24.4
Biocon	349	18.4	16.9	20.2	19.0	20.6	17.2	10.9	11.1	9.3	18.1	14.9	15.9
Glenmark Pharma	309	12.5	16.4	20.8	24.8	18.8	14.9	17.3	10.2	10.5	17.4	18.8	19.0
Torrent Pharma	578	31.9	40.2	50.1	18.1	14.4	11.5	12.2	9.3	7.6	29.2	29.2	28.7

Source: MOSL

Key investment risks

Regulatory risks

1) **National Pharmacutical Pricing Policy (NPPP) 2011:** The newly proposed NPPP intends to bring total 348 drugs under price control resulting in a significant increase in span of control to 50-60% from the current 20%. The policy if implemented could have negative impact on the industry including Ipca.
   Mitigant: IPCA's management has indicitated that if the policy is implemented in its current form the company will have to reduce the prices for pain management and Anti Malaria durgs. However the company as stated that the impact would be minimul at 2-3%.

2) **US - Strict FDA norms:** In the recent times, we have observed that USFDA is becoming more and more stringent regarding cGMP norms and has taken action against many pharma companies including Indian companies. Any similar action taken by USFDA may impact company's US business.

Pricing risks

1) **UK:** High competition in UK poses a risk of further price erosion.
   Mitigant: We believe IPCA's vertical integration will help cushion any major impact on its profitability.

2) **API:** This is a commodity business, and is vulnerable to competitive pricing.
   Mitigant: We believe IPCA's global market leadership in its select segments, lowest cost producer status and reasonable pricing strategy do not leave much room for under-cutting.

Currency risk

As 55% of IPCA's revenue comes from exports, sustained appreciation of the Indian rupee vis-à-vis global currencies would adversely impact revenue and profits.

Mitigant: IPCA's six-month forward cover hedging policy partly mitigates short-term currency risk. Over the long-term, the only possible mitigant is to sustain cost competitiveness via economies of scale.

Financials and valuation

Income statement (INR Million)

Y/E March	2008	2009	2010	2011	2012E	2013E
Net Revenues	**10,652**	**12,888**	**15,622**	**18,969**	**22,290**	**26,284**
Change (%)	13.8	21.0	21.2	21.4	17.5	17.9
EBITDA	**1,817**	**2,653**	**3,335**	**3,761**	**4,645**	**5,648**
Margin (%)	17.1	20.6	21.3	19.8	20.8	21.5
Depreciation	325	397	467	558	662	800
EBIT	**1,492**	**2,257**	**2,868**	**3,203**	**3,983**	**4,848**
Int. and Finance Charges	204	318	264	314	407	473
Other Income - Rec.	28	21	25	83	112	157
PBT before EO Expense	**1,316**	**1,960**	**2,629**	**2,973**	**3,689**	**4,532**
Extra Ordinary Expense/(Income)	-436	777	-33	-434	181	0
PBT after EO Expense	**1,753**	**1,183**	**2,663**	**3,407**	**3,508**	**4,532**
Current Tax	296	155	485	770	738	906
Deferred Tax	62	78	142	14	184	227
Tax	358	233	627	784	922	1,133
Tax Rate (%)	27.2	11.9	23.9	26.4	25.0	25.0
Reported PAT	**1,395**	**951**	**2,035**	**2,623**	**2,586**	**3,399**
Less: Minority Interest						
Net Profit	1,395	951	2,035	2,623	2,586	3,399
Adj PAT	**958**	**1,727**	**2,002**	**2,189**	**2,766**	**3,399**

Balance Sheet (INR Million)

Y/E March	2008	2009	2010	2011	2012E	2013E
Equity Share Capital	251	250	250	251	251	251
Total Reserves	5,642	6,063	8,399	10,265	12,333	15,052
Net Worth	**5,892**	**6,313**	**8,649**	**10,516**	**12,585**	**15,304**
Deferred liabilities	574	651	793	807	992	1218
Total Loans	3,530	4,594	4,545	5,308	6,308	6,308
Capital Employed	**9,996**	**11,554**	**13,981**	**16,625**	**19,885**	**22,830**
Gross Block	5,789	7,790	8,812	9,884	12,184	14,484
Less: Accum. Deprn.	1,646	2,022	2,433	2,892	3,554	4,354
Net Fixed Assets	**4,143**	**5,768**	**6,379**	**6,992**	**8,630**	**10,130**
Capital WIP	1,276	144	383	1,132	1,132	1,132
Investments	95	412	325	408	634	634
Curr. Assets	**6,055**	**7,392**	**8,992**	**10,586**	**12,908**	**15,111**
Inventory	2,676	3,062	3,802	4,664	5,533	6,595
Account Receivables	2,595	3,391	3,880	4,637	5,471	6,595
Cash and Bank Balance	94	107	108	104	537	310
Loans & Advances	690	832	1,201	1,182	1,368	1,612
Curr. Liability & Prov.	**1,574**	**2,162**	**2,097**	**2,493**	**3,419**	**4,177**
Account Payables	1,371	1,962	1,850	2,073	2,797	3,297
Provisions	203	200	247	420	622	879
Net Current Assets	**4,481**	**5,230**	**6,895**	**8,093**	**9,489**	**10,935**
Appl. of Funds	**9,996**	**11,554**	**13,981**	**16,625**	**19,885**	**22,830**

E: MOSL Estimates

Financials and valuation

Ratios

Y/E March	2008	2009	2010	2011	2012E	2013E
Basic EPS (INR)						
EPS	**7.6**	**13.8**	**16.0**	**17.4**	**22.0**	**27.0**
Cash EPS	13.7	10.8	20.0	25.3	25.8	33.4
BV/Share	47.0	50.5	69.1	83.7	100.1	121.7
Valuation (x)						
P/E				14.6	11.5	9.4
Cash P/E				10.0	9.8	7.6
P/BV				3.0	2.5	2.1
EV/Sales				2.0	1.7	1.4
EV/EBITDA				9.9	8.1	6.7
Dividend Yield (%)				1.5	1.6	2.1
FCF per Share				3.9	4.6	7.4
Return Ratios (%)						
EBITDA Margins (%)	17.1	20.6	21.3	19.8	20.8	21.5
Net Profit Margins (%)	9.0	13.4	12.8	11.5	12.4	12.9
RoE	18.0	28.3	26.8	22.8	24.0	24.4
RoCE	18.4	22.4	24.0	22.7	23.6	24.7
Working Capital Ratios						
Asset Turnover (x)	1.8	1.7	1.8	1.9	1.8	1.8
Fixed Asset Turnover (x)	2.7	2.6	2.6	2.8	2.9	2.8
Debtor (Days)	85	93	88	87	87	89
Inventory (Days)	92	87	89	90	91	92
Working Capital Turnover (Days)	150	145	159	154	147	148
Growth (%)						
Sales	13.8	21.0	21.2	21.4	17.5	17.9
EBITDA	-10.8	46.0	25.7	12.8	23.5	21.6
PAT	-23.8	80.2	15.9	9.3	26.4	22.9
Leverage Ratio (x)						
Current Ratio	3.8	3.4	4.3	4.2	3.8	3.6
Interest Cover Ratio	7.3	7.1	10.9	10.2	9.8	10.2
Debt/Equity	0.6	0.7	0.5	0.5	0.5	0.4

E: MOSL Estimates

Financials and valuation

Cash Flow Statement (INR Million)

Y/E March	2008	2009	2010	2011	2012E	2013E
Oper. Profit/(Loss) before Tax	1,817	2,653	3,335	3,761	4,645	5,648
Interest/Dividends Recd.	28	21	25	83	112	157
Direct Taxes Paid	-296	-155	-485	-770	-738	-906
(Inc)/Dec in WC	-1,260	-736	-1,664	-1,203	-963	-1,673
CF from Operations	**290**	**1,784**	**1,212**	**1,872**	**3,057**	**3,226**
EO Expense / (Income)	-436	777	-33	-434	181	0
CF from Operating incl EO Exp.	**726**	**1,007**	**1,245**	**2,307**	**2,876**	**3,226**
(inc)/dec in FA	-1,386	-869	-1,261	-1,821	-2,300	-2,300
(Pur)/Sale of Investments	-9	-316	86	-83	-225	0
CF from Investments	**-1,395**	**-1,185**	**-1,174**	**-1,904**	**-2,525**	**-2,300**
Issue of shares	1	-1	1	1	0	0
(Inc)/Dec in Debt	1,141	1,060	-50	762	1,007	0
Interest Paid	-204	-318	-264	-314	-407	-473
Dividend Paid	-235	-323	-409	-468	-517	-680
Others	-41	-227	653	-388	0	0
CF from Fin. Activity	**662**	**191**	**-70**	**-407**	**83**	**-1,153**
Inc/Dec of Cash	**-7**	**13**	**1**	**-4**	**434**	**-227**
Add: Beginning Balance	101	94	107	108	104	537
Closing Balance	**94**	**107**	**108**	**104**	**537**	**310**

E: MOSL Estimates

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