

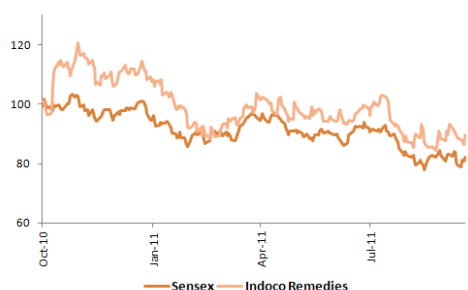
VISIT NOTE

Industry **Pharmaceuticals**

Market Data

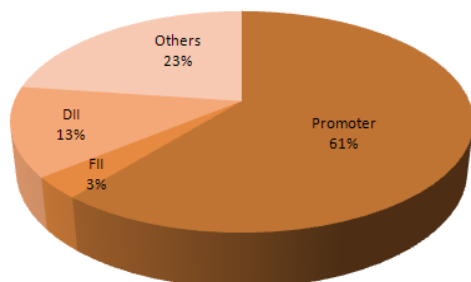
Market Cap.	₹. 4.9bn/ US\$ 108.7mn
Share Cap. (mn)	12.3
52 Wk High/Low	552 /373
Avg. Vol. (Weekly)(‘000)	6.8

(Price Performance (RIC: INRM.BO, BB: INDR.IN))



Shareholding Pattern (As on June 30, 2011)

(%)



Financials (₹. Mn)	FY09	FY10	FY11
Total Revenue	3506.3	3982.8	4784.7
Growth %	0.1	13.6	20.1
EBITDA	458.1	536.6	644.4
EBITDA margin %	13.1	13.5	13.5
Net Profit	314.5	420.9	511.2
EPS (₹)	25.0	34.1	41.6
CEPS (₹)	34.1	43.9	52.6
EV/EBITDA	11.3	9.6	8.7
EV/Sales	1.5	1.3	1.2
ROE %	11.0	13.5	14.6
ROCE %	10.8	11.5	12.4
P/E (x)	15.9	11.7	9.6
P/CEPS (x)	11.7	9.1	7.6

Indoco Remedies (INDR IN)

October 18, 2011

Bets big on formulation exports

Not Rated (CMP: ₹398)

Mkt Cap: ₹ 4.9bn; USD 108.7mn

We recently met the management of Indoco Remedies to get an update on its domestic formulations operation, exports initiatives and the supply pacts signed with global generic players like Watson, Aspen, etc. The key highlights are as follows:

Hopeful about domestic formulations achieving industry growth

Indoco has traditionally been a domestic branded formulation-focused company with strong brand equity position in Anti-infectives, Respiratory, Dental, Gastro intestinal and ophthalmic. Its domestic formulation business accounting for 65% of total sales delivered a steady growth (almost in line with the Indian pharma industry) over the last decade. Of late, over the past two quarters, Indoco has grossly underperformed the industry growth by improving at ~5% (v/s industry growth of 12-15%), led by an overall decline in its antibiotic segment (that accounts for ~22% of its total sales) and price competition in the domestic formulations market. Additionally, Indoco is largely (i.e ~80%) dependent on low-growth acute therapies. Hence, we remain cautious about Indoco's domestic sales growth in the near term, though the company is hopeful that its domestic formulation sales to achieve industry growth.

Export formulation to maintain steady growth

Formulation exports (i.e 30% of total sales) have been key growth driver for Indoco, as it displayed a compounded annual growth of 30% over FY06-FY11 to ₹1,565mn in FY11. Going forward, the management expects stronger growth in its formulation exports, led by its manufacturing & supply pact with Aspen (for emerging markets including Australia) and Watson (for the US market). Additionally, its supply pact for AOK-led German market and increasing product registration across emerging as well as regulated markets will support growth. However, we expect formulation exports growth at a CAGR of ~25% over the next two years for Indoco.

Profitable growth in formulation exports only from FY14 onwards

Although Indoco expects to commence the supply of drugs to Aspen for its emerging market operation (including Australia) from H2FY12 onwards, we believe that it may not enhance profitability as the initial supplies would be pure contract manufacturing of low-margin generic products. It is only the supply of its out-licensed products to Aspen and Watson for sterile and complex products (which are most likely to be supplied at the fag-end of FY13) would result in profitable growth in its formulation exports.

Margin expansion is a challenge over the near term

We believe Indoco will face margin pressure in the near term led by 1) decreasing contribution from better-margin domestic formulation, 2) continued expansion in field force, 3) higher contribution from low-margin contract manufacturing, and 4) under utilization of newly set up facility at Goa. Hence, we believe Indoco's margin will move in a narrow range of 14-15% over FY11-13.

Valuations: Indoco to trade as market performer

At the CMP of ₹398, Indoco trades at 8 times our preliminary FY13 EPS estimate (i.e ₹ 50.3), against its historical trend of 10x its 1-year forward multiple. We believe the current discount in valuation is mainly due to weak macro environment and no major earnings trigger in the near term. Hence, we expect Indoco to trade as market performer in the near term.

Surya Narayan Patra
suryapatra@systematixshares.com
(+91 22 3029 8186)

Table 1: Recent quarterly performance of Indoco Remedies

	Q1FY09	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11
Net sales	98.3	95.4	95.7	108.9	111.4	132.3	114.3	120.4	125.6
% yoy change	-11.3	22.5	22.8	28.1	13.3	38.7	19.4	10.6	12.7
Other Operating Income	2.3	0.6	0.3	1.5	1.3	3.1	1.2	2.4	1.5
Total Operating Income	100.6	96.1	96.0	110.3	112.7	135.4	115.5	122.8	127.1
% yoy change	-9.2	22.2	22.2	27.7	12.0	41.0	20.4	11.3	12.7
Adjusted RM cost	40.3	40.7	41.5	51.5	48.5	60.6	51.0	53.2	54.0
Gross margin (%)	60.0	57.6	56.7	53.3	57.0	55.3	55.8	56.7	57.5
Staff costs	12.9	14.5	14.2	14.9	14.8	18.5	16.2	17.5	18.1
R&D	2.5	2.3	2.5	3.0	1.9	2.2	2.6	2.7	2.3
Other expenditure	24.0	25.6	26.3	28.4	28.5	33.3	31.3	31.5	34.1
Total Expenditure	79.7	83.0	84.5	97.7	93.6	114.6	101.0	104.9	108.5
% yoy change	-1.9	14.0	16.4	24.8	17.5	38.1	19.5	7.3	15.8
Operating Profit	20.92	13.08	11.43	12.61	19.07	20.83	14.49	17.96	18.60
% yoy change	-29.4	124.4	92.7	55.3	-8.8	59.3	26.8	42.4	-2.5
% qoq change	157.6	-37.5	-12.6	10.3	51.2	9.2	-30.4	23.9	3.6
OPM (%)	20.8	13.6	11.9	11.4	16.9	15.4	12.5	14.6	14.6
Interest	0.9	0.7	0.6	0.7	0.7	0.5	0.6	0.6	0.9
Depreciation	2.8	2.9	3.0	3.4	3.2	3.4	3.4	3.5	3.9
PBT	17.3	9.6	7.8	8.5	15.2	17.0	10.5	13.9	13.8
% yoy change	-30.7	238.9	437.9	121.9	-12.0	76.9	34.6	62.7	-9.3
Total tax	0.4	0.3	0.1	0.5	0.4	1.7	1.7	1.7	2.1
Tax incidence (%)	2.3	3.5	0.9	6.0	2.6	10.0	16.1	12.3	14.9
Net profit	16.88	9.25	7.73	8.01	14.82	15.26	8.81	12.16	11.74
% yoy change	-30.5	326.3	1127.0	104.3	-12.2	65.0	14.0	51.8	-20.8
Net profit margin (%)	16.8	9.6	8.1	7.3	13.1	11.3	7.6	9.9	9.2
EPS	13.7	7.5	6.3	6.5	12.1	12.4	7.2	9.9	9.6

Source: Company and Systematix Institutional Research

Table 2: Profit And Loss Account (₹ Mn)

Year to Mar	FY07	FY08E (9m)	FY09	FY10	FY11
Net Sales	3,259.9	2,626.8	3,506.3	3,982.8	4,784.7
% Growth	33.9	(19.4)	0.1	13.6	20.1
EBIDTA	593.9	427.7	458.1	536.6	644.4
% Growth	24.2	(28.0)	7.2	17.2	20.1
Other Income	29.3	25.0	39.3	44.7	80.0
Interest	50.9	36.2	58.5	29.1	24.0
Depreciation	90.3	77.8	111.6	121.0	134.5
PBT	482.0	338.7	327.3	431.3	565.8
% Growth	12.2	(29.7)	(3.3)	31.8	31.2
Tax	44.7	19.5	20.3	12.5	54.7
Deferred Tax					
PAT	437.3	319.2	307.0	418.7	511.2
% Growth	38.9	(27.0)	(3.5)	36.4	22.1
Dividend yield (%)	1.6	1.7	1.7	1.7	1.7
EPS (₹)	37.0	26.0	25.0	34.1	41.6
BVPS (₹)	197.3	206.9	226.6	252.7	285.0

Source: Company and Systematix Institutional Research

Table 3: Balance sheet (₹ Mn)

Year to Mar	FY07	FY08E (9m)	FY09	FY10	FY11
Eqty Cap	118.2	122.9	122.9	122.9	122.9
Reserves	2,214.3	2,419.6	2,661.6	2,982.2	3,379.1
Networth	2,332.5	2,542.5	2,784.5	3,105.1	3,502.0
Secured loans	348.2	221.4	399.4	569.6	919.7
Unsecured loans	7.3	121.1	157.9	90.8	79.7
Total loans	355.5	342.5	557.4	660.4	999.4
Deffered Tax Liab	206.9	219.2	230.2	242.5	257.2
Total Liability	2,894.9	3,104.2	3,572.1	4,008.0	4,758.6
Net Block	1,688.6	1,734.5	1,922.2	2,279.1	2,948.0
Investments	0.0	0.0	0.0	0.2	0.2
Deffered Tax Assets	-	-	-	-	-
Inventory	380.0	443.3	524.8	691.2	804.2
Debtors	1,037.0	1,077.6	1,003.3	907.1	917.9
Cash balance	153.0	161.2	290.2	375.5	270.5
Other CA	206.0	309.3	415.1	537.0	691.3
Current Liabilities	574.9	517.6	521.5	636.6	709.8
Provisions	109.9	108.4	63.9	146.1	163.8
NCA	1,201.1	1,365.4	1,648.0	1,728.1	1,810.2
Misc Exp	5.3	4.3	1.4	0.1	0.5
Total Assets	2,894.9	3,104.2	3,572.1	4,008.0	4,758.6

Source: Company and Systematix Institutional Research

Table 4: Ratio Analysis

Year to Mar	FY07	FY08E (9m)	FY09	FY10	FY11
OPM %	18.2	16.3	13.1	13.5	13.5
NPM %	13.4	12.2	8.8	10.5	10.7
ROE %	18.7	12.6	11.0	13.5	14.6
ROCE %	18.4	12.1	10.8	11.5	12.4
Int. Cover (x)	12.3	12.5	8.5	20.0	30.2
D/E (x)	0.2	0.1	0.2	0.2	0.3
Asset Turnover (x)	1.6	1.2	1.5	1.5	1.6
Debtors Days	116.1	149.7	104.4	83.1	70.0
Inventory Days	42.5	61.6	54.6	63.3	61.3
Valuation ratios	-	-	-	-	-
P/CF per share (x)	8.9	12.3	11.7	9.1	7.6
EV/Cash Profit (x)	13.0	9.6	13.0	3.1	(3.4)
EV/EBIDTA (x)	8.3	11.9	11.3	9.6	8.7
EV/Sales (x)	1.5	1.9	1.5	1.3	1.2
Mkt Cap/Sales(x)	1.4	1.9	1.4	1.2	1.0
CEPS (₹)	44.6	32.3	34.1	43.9	52.6
P/ BV (x)	2.0	1.9	1.8	1.6	1.4

Source: Company and Systematix Institutional Research

Table 5: Cash Flow Statement (₹ Mn)

Year to Mar	FY07	FY08E (9m)	FY09	FY10	FY11
PAT	420.4	301.0	314.5	420.9	511.2
Depreciation	90.3	77.8	111.6	121.0	134.5
Change in WC	(286.0)	(156.1)	(153.6)	5.1	(187.1)
Operating CF	224.7	222.7	272.4	547.0	458.7
Capex	(382.5)	(124.6)	(297.9)	(475.2)	(799.5)
Misc Exp	96.0	(121.2)	86.7	10.8	11.1
Investing CF	(286.5)	(245.8)	(211.2)	(464.4)	(788.4)
Equity	(0.0)	116.3	(111.6)	0.0	0.0
Dividends	(93.4)	(71.9)	(35.5)	(100.3)	(114.2)
Debt	(7.1)	(13.0)	214.9	103.0	339.0
Investments	63.3	(0.0)	0.0	(0.2)	0.0
Financing CF	(37.2)	31.4	67.7	2.5	224.7
Net Change	(99.0)	8.3	129.0	85.2	(105.0)
Opening Cash	252.0	153.0	161.2	290.2	375.5
Closing Cash	153.0	161.2	290.2	375.5	270.5

Source: Company and Systematix Institutional Research

For any queries contact us at: Institutional Team

N. Subramaniam	Sr. VP & Head – Sales & Sales Trading	+91- 22-3029 8285	nsubramaniam@systematixshares.com
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Equity Sales

Mamta Singh	AVP– Sales	+91-22-3029 8092	mamtasingh@systematixshares.com
Ridhim Thapar	AVP– Sales	+91-22-3029 8265	ridhimt@systematixshares.com

Derivatives

Abhishek Karande	Technical Analyst	+ 91-22-3029 8261	abhishekk@systematixshares.com
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Sales Trading / Dealing

Priya Kartik	AVP - Sales Trading	+ 91-22-3029 8091	priyakartik@systematixshares.com
Sachin Parekh	Sr. Manager	+ 91-22-3029 8291	sachinp@systematixshares.com
Jigar Kamdar	Sales Trader	+ 91-22-3029 8181	jigarkamdar@systematixshares.com
Vinod Bhuvad	Sales Trader	+ 91-22-3029 8267	vinodbhuvad@systematixshares.com
Nayan Narnoli	Derivatives Dealer	+ 91-22-3029 8180	nayan@systematixshares.com
Monish Lotia	Derivatives Dealer	+ 91-22-3029 8252	monishlotia@systematixshares.com

Equity Research

Telephone: + 91-22- 3029 8000

RESEARCH ANALYST	SECTOR ALLOCATION	DIRECT Nos.	E-mail
Sudarshan Narasimhan	Sr. VP & Head of Research –Oil & Gas, Petrochemicals	+ 91-22-3029 8293	sudarshan@systematixshares.com
Vinod Chari	VP - Capital Goods	+ 91-22-3029 8263	vinodchari@systematixshares.com
Surya Narayan Patra	AVP - Pharma	+ 91-22-3029 8186	suryapatra@systematixshares.com
Eric Martins	AVP – Metals & Mining, Pipes	+ 91-22-3029 8253	eric@systematixshares.com
Shreegopal Jaju	AVP – Capital Goods	+ 91-22-3029 8187	gopaljaju@systematixshares.com
Jyoti Khatri	AVP – Banking	+ 91-22-3029 8296	jyotikhatri@systematixshares.com
Anurag Purohit	AVP – IT	+ 91-22-3029 8258	anuragp@systematixshares.com
Binod Modi	Sr. Analyst – Cement & Construction	+ 91-22-3029 8264	binodmodi@systematixshares.com
Rohit Jain	Analyst - Real Estate	+ 91-22-3029 8269	rohitj@systematixshares.com
Rahul Agarwal	Analyst	+ 91-22-3029 8260	rahulagarwal@systematixshares.com
Prateek Khandelwal	Associate	+ 91-22-3029 8259	prateekk@systematixshares.com

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BUY (B) The stock's total return is expected to exceed 20% over the next 12 months.
ACCUMULATE (A) The stock's total return is expected to be within 10-20% over the next 12 months.
HOLD (H) The stock's total return is expected to be within 0-10% over the next 12 months.
SELL (S) The stock's total return is expected to give negative returns over the next 12 months.
NOT RATED (NR) The analyst has no recommendation on the stock under review.

Industry Views

ATTRACTIVE (AT) Fundamentals/Valuations of the sector are expected to be attractive over the next 12-18 months.
NEUTRAL (NL) Fundamentals/Valuations of the sector are expected to neither improve nor deteriorate over the next 12-18 months.
CAUTIOUS (CS) Fundamentals/Valuations of the sector are expected to deteriorate over the next 12-18 months.

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SYSTEMATIX SHARES & STOCKS (I) LTD.

Head Office J. K. Somani Building, 2nd Floor, British Hotel Lane,
Fort, Mumbai, Pin: 400001, Tel: +91 22 66198000, Fax: +91 22 66198029

Registered Office EGA Trade Center, 4th Floor, 809-, Poonamalle High Road,
Kilpauk, Chennai, Pin: 600010Tel: +91 44 26612184/ 87/ 88Fax: +91 44 26612190