

Management meet update

Confident on solid growth foundation; Retain Buy

We recently hosted IPCA management for Investor meetings and came back reassured of robust growth path driven by surge in formulations business. While domestic formulation remains IPCA's strong hold, export formulations to throw positive surprises post facility approval by USFDA in near term.

Recent fieldforce additions to boost domestic business

IPCA has doubled its domestic formulations (38% of sales) fieldforce in the last two years to 4000+ now. Much of the increment has been to strengthen capabilities in Pain, CVS segment. We expect domestic formulation business to sustain 20%+ growth rates over medium term as new fieldforce becomes productive, also aiding margin expansion. Increasing penetration in tier 2/3 cities & expanding coverage to 0.5mn doctors (of total 0.8mn in India) remains medium term focus for the co. Company aims to have atleast 2-3 Rs1bn+ brands by 2012.

Indore SEZ USFDA approval remains key upside catalyst

IPCA's US generic business faces capacity constraints currently and USFDA approval for Indore SEZ remains key to support its growth plans. With no revenues from the facility currently, the company is incurring unabsorbed fixed overheads of Rs220mn p.a (inc. depreciation). IPCA can potentially grow its US business multi-fold (to Rs3bn) from Rs750mn currently in next 3-4 years given robust demand for approved products as well as new filings. Near-term facility inspection and approval would pave way for improved profitability & visibility.

Stable business; Reasonable valuations

IPCA trades at 13.6x FY12E EPS, at 25-30% discount to the sector, which is reasonable considering stable domestic business (45% of sales), growing export formulations and strong financial health (D/E of 0.4x; RoE of 24-26%). We expect valuation gap with peers to narrow on sustained growth (21% EPS CAGR).

Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	960	2,054	2,255	3,046	3,656
EPS	8.06	16.42	18.03	24.35	29.22
EPS Change (YoY)	-25.6%	103.7%	9.8%	35.1%	20.0%
Dividend / Share	2.58	2.80	3.00	3.25	3.25
Free Cash Flow / Share	8.84	3.72	11.89	13.33	21.57

Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	41.05x	20.15x	18.35x	13.59x	11.32x
Dividend Yield	0.780%	0.846%	0.907%	0.982%	0.982%
EV / EBITDA*	17.46x	14.01x	12.40x	9.89x	8.29x
Free Cash Flow Yield*	2.67%	1.13%	3.59%	4.03%	6.52%

* For full definitions of *iQmethod*SM measures, see page 4.

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Stock Data

Price	Rs330.80
Price Objective	Rs365.00
Date Established	24-Oct-2010
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs184.00-Rs348.55
Mkt Val / Shares Out (mn)	US\$917 / 125.1
Average Daily Volume	174,763
BofAML Ticker / Exchange	XBLAF / BSE
Bloomberg / Reuters	IPCA IN / IPCA.BO
ROE (2011E)	23.5%
Net Dbt to Eqty (Mar-2010A)	51.3%
Est. 5-Yr EPS / DPS Growth	24.0% / 15.0%
Free Float	53.8%

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iQprofileSM IPCA Labs

Key Income Statement Data (Mar)	2009A	2010A	2011E	2012E	2013E
(Rs Millions)					
Sales	12,926	15,666	17,967	21,680	25,761
Gross Profit	7,854	9,210	10,723	12,991	15,435
Sell General & Admin Expense	(4,714)	(5,331)	(6,271)	(7,444)	(8,821)
Operating Profit	2,256	2,838	3,219	4,110	4,938
Net Interest & Other Income	(1,073)	(176)	(229)	(179)	(168)
Associates	NA	NA	NA	NA	NA
Pretax Income	1,183	2,663	2,989	3,931	4,770
Tax (expense) / Benefit	(280)	(627)	(754)	(906)	(1,136)
Net Income (Adjusted)	960	2,054	2,255	3,046	3,656
Average Fully Diluted Shares Outstanding	125	125	125	125	125

Key Cash Flow Statement Data

Net Income	960	2,054	2,255	3,046	3,656
Depreciation & Amortization	397	467	518	573	650
Change in Working Capital	(736)	(1,664)	(537)	(1,353)	(1,635)
Deferred Taxation Charge	78	142	156	159	163
Other Adjustments, Net	1,276	727	887	992	1,215
Cash Flow from Operations	1,974	1,726	3,279	3,418	4,049
Capital Expenditure	(869)	(1,261)	(1,792)	(1,750)	(1,351)
(Acquisition) / Disposal of Investments	NA	NA	NA	NA	NA
Other Cash Inflow / (Outflow)	(316)	86	213	16	(609)
Cash Flow from Investing	(1,185)	(1,174)	(1,579)	(1,734)	(1,960)
Shares Issue / (Repurchase)	(1)	0	0	0	0
Cost of Dividends Paid	(323)	(350)	(375)	(407)	(407)
Cash Flow from Financing	(769)	(558)	(1,514)	(1,504)	(1,719)
Free Cash Flow	1,105	466	1,487	1,668	2,698
Net Debt	4,486	4,437	4,077	3,864	3,464
Change in Net Debt	1,050	(49)	(361)	(213)	(401)

Key Balance Sheet Data

Property, Plant & Equipment	5,768	6,379	7,861	9,037	9,737
Other Non-Current Assets	556	708	287	272	882
Trade Receivables	3,391	3,880	4,459	5,441	6,466
Cash & Equivalents	113	108	294	473	843
Other Current Assets	3,893	5,004	5,292	6,387	7,591
Total Assets	13,722	16,078	18,194	21,610	25,519
Long-Term Debt	4,599	4,545	4,371	4,337	4,307
Other Non-Current Liabilities	651	793	872	960	1,055
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	2,162	2,097	2,428	3,152	3,746
Total Liabilities	7,412	7,435	7,671	8,449	9,109
Total Equity	6,309	8,643	10,522	13,161	16,411
Total Equity & Liabilities	13,722	16,078	18,194	21,610	25,519

iQmethodSM - Bus Performance*

Return On Capital Employed	16.0%	17.0%	16.2%	18.5%	18.7%
Return On Equity	15.7%	27.5%	23.5%	25.7%	24.7%
Operating Margin	17.6%	18.2%	18.0%	19.0%	19.2%
EBITDA Margin	20.5%	21.1%	20.8%	21.6%	21.7%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	2.1x	0.8x	1.5x	1.1x	1.1x
Asset Replacement Ratio	2.2x	2.7x	3.5x	3.1x	2.1x
Tax Rate (Reported)	23.7%	23.6%	25.2%	23.1%	23.8%
Net Debt-to-Equity Ratio	71.1%	51.3%	38.7%	29.4%	21.1%
Interest Cover	6.0x	10.8x	12.0x	17.2x	19.0x

Key Metrics

* For full definitions of iQmethodSM measures, see page 4.

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 20% EPS growth over the next two years driven by 19% 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.

Stock Data

Price to Book Value 3.9x

Price objective basis & risk

IPCA Labs (XBLAF)

Our PO of Rs365 is based on 15x FY12E EPS of Rs24.3. Our target multiple is at a discount to Indian pharma peers trading at c18x 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 (21% earnings growth) and improving business mix. Higher upside from Artemether-Lumefantrine tender (WHO) and earlier than expected USFDA approval for Indore SEZ may provide upside 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.

Analyst Certification

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India - Healthcare Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
BUY				
	BIOCON LTD	BCLTF	BIOS IN	Arvind Bothra
	CADILA HEALTHCAR	CDLHF	CDH IN	Arvind Bothra
	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
NEUTRAL				
	Ranbaxy Laboratories Limited	XIZZF	RBXY IN	S.Arun
UNDERPERFORM				
	GSK India	GXOLF	GLXO IN	Arvind Bothra
	Piramal Healthcare Ltd	XNIGF	PIHC IN	Arvind Bothra

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
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

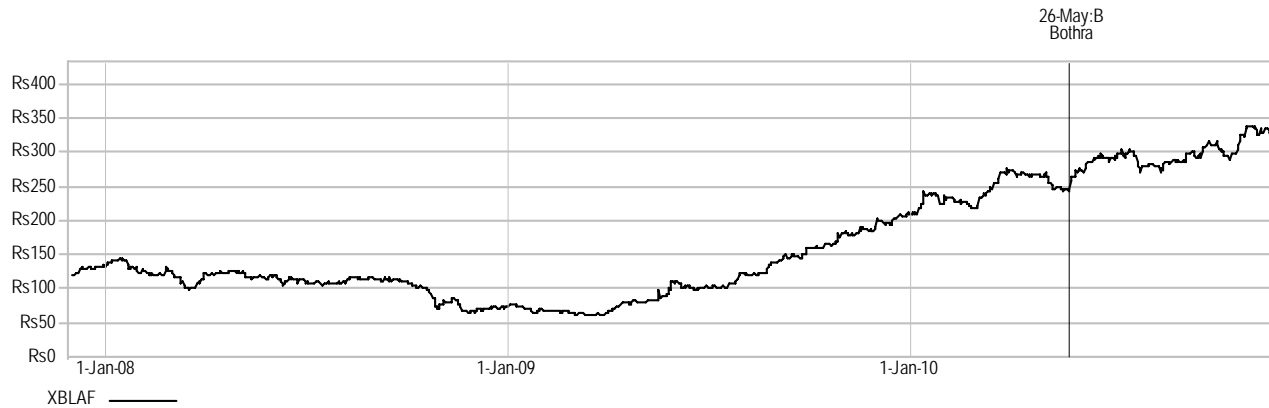
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XBLAF Price Chart



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

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Investment Rating Distribution: Health Care Group (as of 01 Oct 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	122	53.51%	Buy	52	45.61%
Neutral	55	24.12%	Neutral	31	59.62%
Sell	51	22.37%	Sell	16	32.00%

Investment Rating Distribution: Global Group (as of 01 Oct 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1948	54.31%	Buy	821	46.73%
Neutral	891	24.84%	Neutral	397	49.07%
Sell	748	20.85%	Sell	259	37.16%

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Buy	≥ 10%	≤ 70%
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Underperform	N/A	≥ 20%

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