

USFDA approval for Indore SEZ aids visibility; Raise PO



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Raise PO on improved visibility; Reiterate Buy

The much-awaited approval of IPCA's Indore SEZ facility by USFDA opens up growth opportunities for IPCA. While we had factored this for 2HFY13, an earlier approval improves sales visibility for the US business, facing supply constraints currently. We raise our sales forecasts by ~3%, mainly on higher US sales, leading to an EPS estimate increase of 2-3%. Accordingly, we raise our PO to Rs450, to factor (a) the higher EPS estimates and (b) a likely re-rating to 15x FY13E P/E (vs. 14x) on higher visibility.

Indore SEZ approval opens up US growth prospects

The prolonged delay in approval of Indore SEZ by USFDA post inspection in Jan'12 had constrained IPCA's US sales growth, facing capacity shortage currently. Moreover, lack of sales from the unit also led to unabsorbed fixed overheads of Rs220mn p.a (inc. depreciation), which can now be recovered. We expect a ramp-up in ANDA approvals from the facility (5 pending) and site transfers to accelerate growth, as commercial shipments to the US would commence in 4QFY13. We now expect US business to potentially double by FY15E, to Rs3.5bn (10% of sales, 26% CAGR), with improved profitability on the rising scale of operations.

Revival in domestic formulations growth to aid re-rating

Post weak performance in FY12 (up 8%), we expect IPCA's domestic formulation growth to revert to the historical average (17% CAGR over FY06-12) going ahead. We expect an 18% CAGR in domestic formulations (33% of sales) to be driven by (a) the impact of productivity improvement of the new fieldforce (1500+ added in the last 2 years), (b) increased penetration to tier 2/3 cities and (c) expanded doctor coverage.

Valuation gap to narrow on strong earnings momentum

IPCA trades at 12.8x FY13E EPS, a 25-30% discount to the sector, which is likely to narrow on (a) a 23% EPS CAGR, (b) 24-26% RoEs, and (c) a strong domestic franchise. For 1Q, we expect PAT (ex-forex) at Rs756mn (up 38%), led by 17% sales growth and 32% growth in EBITDA (230bps margin expansion).

Estimates (Mar)

(Rs)	2011A	2012A	2013E	2014E	2015E
Net Income (Adjusted - mn)	2,628	2,771	3,788	4,497	5,202
EPS	21.01	21.96	30.02	35.65	41.24
EPS Change (YoY)	28.0%	4.5%	36.7%	18.7%	15.7%
Dividend / Share	3.20	3.20	3.50	3.75	3.75
Free Cash Flow / Share	5.22	13.03	25.62	21.98	31.72

Valuation (Mar)

	2011A	2012A	2013E	2014E	2015E
P/E	18.77x	17.96x	13.14x	11.06x	9.56x
Dividend Yield	0.811%	0.811%	0.887%	0.951%	0.951%
EV / EBITDA*	14.89x	10.91x	8.83x	7.72x	6.76x
Free Cash Flow Yield*	1.32%	3.30%	6.50%	5.57%	8.04%

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

Stock Data

Price	Rs394.40
Price Objective	Rs450.00
Date Established	22-Jul-2012
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs225.00-Rs400.80
Mrkt Val / Shares Out (mn)	US\$895 / 125.1
Market Value (mn)	Rs49,339
Average Daily Volume	118,729
BofAML Ticker / Exchange	XBLAF / BSE
Bloomberg / Reuters	IPCA IN / IPCA.BO
ROE (2013E)	26.6%
Net Dbt to Eqty (Mar-2012A)	47.4%
Est. 5-Yr EPS / DPS Growth	22.0% / 15.0%
Free Float	53.8%

Key Changes

(Rs)	Previous	Current
Price Obj.	405.00	450.00
2013E Rev (m)	27,196.1	28,114.1
2014E Rev (m)	31,431.5	32,394.9
2015E Rev (m)	NA	37,010.3
2013E EPS	28.93	30.02
2014E EPS	34.82	35.65
2015E EPS	NA	41.24

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Refer to important disclosures on page 5 to 7. Analyst Certification on Page 3. Price Objective Basis/Risk on page 3. Link to Definitions on page 3. 11185911

22 July 2012

iQprofileSM IPCA Labs

Key Income Statement Data (Mar)	2011A	2012A	2013E	2014E	2015E
(Rs Millions)					
Sales	18,989	23,587	28,114	32,395	37,010
Gross Profit	11,224	14,456	17,315	19,935	22,768
Sell General & Admin Expense	(6,750)	(8,542)	(9,862)	(11,401)	(13,019)
Operating Profit	3,203	4,464	5,502	6,309	7,209
Net Interest & Other Income	204	(821)	(346)	(334)	(322)
Associates	NA	NA	NA	NA	NA
Pretax Income	3,407	3,643	5,156	5,975	6,887
Tax (expense) / Benefit	(784)	(881)	(1,377)	(1,487)	(1,695)
Net Income (Adjusted)	2,628	2,771	3,788	4,497	5,202
Average Fully Diluted Shares Outstanding	125	126	126	126	126

Key Cash Flow Statement Data

Net Income	2,628	2,771	3,788	4,497	5,202
Depreciation & Amortization	558	671	845	948	1,079
Change in Working Capital	(1,203)	(696)	(1,503)	(1,909)	(1,732)
Deferred Taxation Charge	14	127	140	143	145
Other Adjustments, Net	476	1,976	1,668	1,771	1,974
Cash Flow from Operations	2,474	4,850	4,936	5,450	6,669
Capital Expenditure	(1,821)	(3,219)	(1,731)	(2,700)	(2,701)
(Acquisition) / Disposal of Investments	NA	NA	NA	NA	NA
Other Cash Inflow / (Outflow)	(83)	75	(765)	(395)	(1,429)
Cash Flow from Investing	(1,904)	(3,145)	(2,496)	(3,095)	(4,130)
Shares Issue / (Repurchase)	1	1	0	0	0
Cost of Dividends Paid	(400)	(404)	(442)	(473)	(473)
Cash Flow from Financing	(574)	(1,686)	(2,183)	(2,296)	(2,477)
Free Cash Flow	653	1,630	3,205	2,750	3,968
Net Debt	5,205	5,940	5,655	5,585	5,525
Change in Net Debt	767	735	(285)	(70)	(59)

Key Balance Sheet Data

Property, Plant & Equipment	6,992	9,441	11,096	12,849	14,469
Other Non-Current Assets	1,540	1,286	1,282	1,677	3,107
Trade Receivables	4,637	3,491	5,310	6,127	7,004
Cash & Equivalents	104	122	379	438	500
Other Current Assets	5,846	8,934	9,103	10,504	12,007
Total Assets	19,118	23,273	27,170	31,594	37,087
Long-Term Debt	5,308	6,061	6,034	6,022	6,025
Other Non-Current Liabilities	807	932	1,025	1,127	1,240
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	2,493	3,740	4,225	4,534	5,183
Total Liabilities	8,609	10,733	11,284	11,683	12,448
Total Equity	10,509	12,540	15,886	19,910	24,639
Total Equity & Liabilities	19,118	23,273	27,170	31,594	37,087

iQmethodSM - Bus Performance*

Return On Capital Employed	16.1%	18.7%	19.0%	19.0%	18.4%
Return On Equity	27.4%	24.0%	26.6%	25.1%	23.4%
Operating Margin	17.0%	19.3%	19.9%	19.7%	19.7%
EBITDA Margin	19.8%	21.8%	22.6%	22.4%	22.4%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	0.9x	1.8x	1.3x	1.2x	1.3x
Asset Replacement Ratio	3.3x	4.8x	2.0x	2.8x	2.5x
Tax Rate (Reported)	23.0%	24.2%	26.7%	24.9%	24.6%
Net Debt-to-Equity Ratio	49.5%	47.4%	35.6%	28.0%	22.4%
Interest Cover	10.2x	10.8x	12.1x	14.0x	16.0x

Key Metrics

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

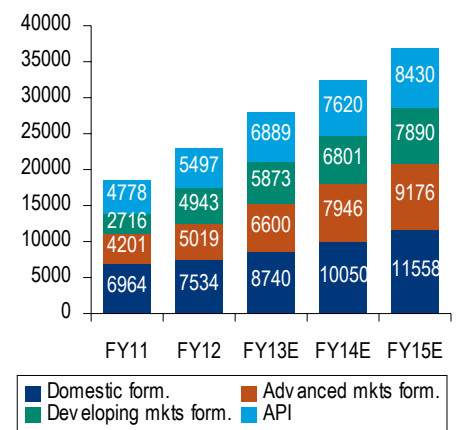
Company Description

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 26% 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 - revenue split



Source: Company, BofA Merrill Lynch Global Research

Stock Data

Price to Book Value

3.1x

Price objective basis & risk

IPCA Labs (XBLAF)

Our PO of Rs450 is based on 15x FY13E EPS of Rs30. Our target multiple is at a discount to Indian pharma peers, trading at c16x FY13E. Our PO is pegged at the upper end of its historical 1-year forward P/E band, as we believe re-rating is justified on a robust earnings growth outlook (18% recurring earnings growth) and improving business mix. Higher upside from the Artemether-Lumefantrine tender (WHO) and stronger-than-expected ramp-up in US generics likely to be key upside risks.

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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22 July 2012

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
	Sun Pharmaceuticals Limited	XPUCF	SUNP 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	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + 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	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

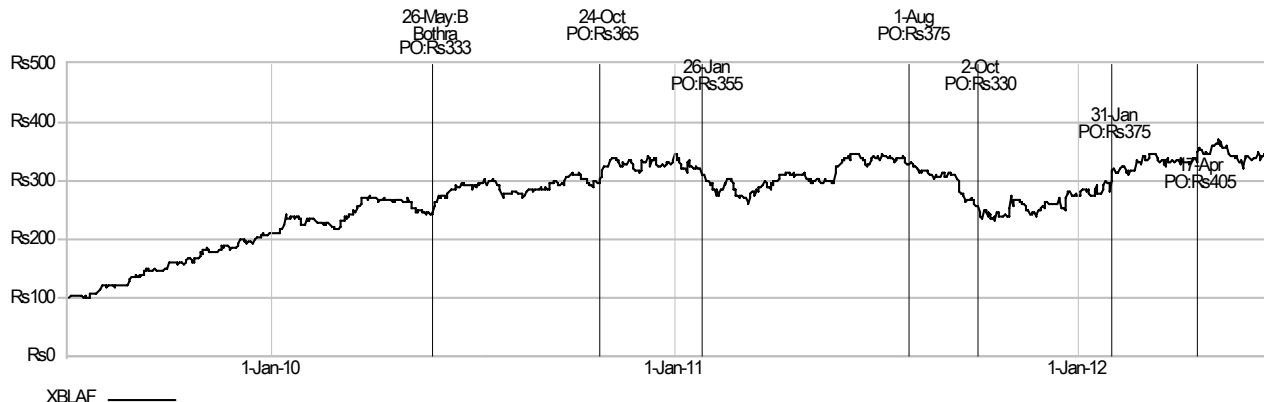
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XBLAF Price Chart



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 June 30, 2012 or such later date as indicated.

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

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	141	54.02%	Buy	104	77.04%
Neutral	67	25.67%	Neutral	42	70.00%
Sell	53	20.31%	Sell	34	66.67%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1913	50.14%	Buy	1294	73.40%
Neutral	994	26.06%	Neutral	628	70.09%
Sell	908	23.80%	Sell	513	60.71%

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Buy	≥ 10%	≤ 70%
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