

30 October 2019

Indoco Remedies

Expect gradual recovery in earnings; retaining a Buy

Rating: **Buy**

Target Price: ₹191

Share Price: ₹159

We believe Indoco's FY20 to be a year of stabilisation after a few hiccups regarding its plants catering to the US. Also, its domestic business has resumed normal growth and EU supply is expected to improve. Post-normalisation of its businesses, we expect a gradual step-up in earnings. We retain our Buy recommendation, at a lower target of ₹191.

Domestic business recovery. Q2 FY20 domestic formulations revenue grew 17% y/y. Therapy-wise, y/y growth was: anti-infectives 32.8%, stomatologicals 16.3%, gastrointestinal 23.6%, respiratory 24.6%, VMN (8.7%), ophthalmologicals 5.9%. We expect domestic formulations to recover to a 12% revenue CAGR (FY19-21), supported by re-structuring, greater productivity of MRs (2,300) and continuous focus on brand-building and launches.

We expect supplies to the US to resume from Q4 FY20. Indoco's US business has recently been under stress due to the regulatory overhang on the Goa II and III plants. Now, on the resolution regarding the US FDA's warning letter, supplies would resume. Management expects supplies to the US (gCusopt, gTrusopt, a few oral solids and injectables) to resume from Q4 FY20, and 2-3 ANDA filings in FY20. We expect ₹326m/₹1,266m revenue in FY20/FY21. The company has 37 ANDAs pending.

EU to pull through after a few hiccups. Full GMP status has been reinstated for Plant I in Sep'19, on the outcome of the recent inspection by the UK-MHRA in May'19 regarding its Goa plant I. Thus, EU supplies are expected to grow. Besides, Baddi plant III (acquired from Microlabs) would help alleviate to some extent the revenue loss. We expect ₹1.75bn/₹1.9bn revenue in FY20/FY21.

Change in estimates. We trim our FY20e EBITDA 18.5% on the higher-than-expected operating cost and, thereby, cut our PAT estimate 38%.

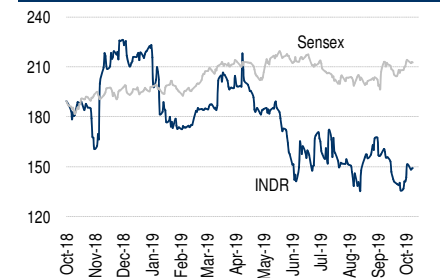
Valuation. We maintain our Buy recommendation on the stock, with a lower target price of ₹191 (earlier ₹194), based on 18x FY21e EPS. **Risks:** Currency fluctuations; escalation of regulatory issues on plants.

Key data	INDR IN / INRM.BO
52-week high / low	₹239 / 132
Sensex / Nifty	40052 / 11844
3-m average volume	\$0.2m
Market cap	₹15bn / \$207.3m
Shares outstanding	92m

Shareholding pattern (%)	Sep '19	Jun '19	Mar '19
Promoters	58.7	58.7	58.7
- of which, Pledged	-	-	-
Free float	41.3	41.3	41.3
- Foreign institutions	2.1	2.1	2.1
- Domestic institutions	14.8	15.2	14.8
- Public	24.5	24.0	24.4

Estimates revision (%)	FY20e	FY21e
Sales	(3.0)	(1.4)
EBITDA	(18.5)	(1.4)
EPS	(38.1)	(1.6)

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY17	FY18	FY19	FY20e	FY21e
Sales (₹ m)	10,968	10,453	9,685	11,323	13,635
Net profit (₹ m)	771	412	-29	305	975
EPS (₹)	8.4	4.5	-0.3	3.3	10.6
PE (x)	29.9	47.2	NM	48.1	15.0
EV / EBITDA (x)	16.1	16.4	22.5	13.9	8.0
PBV (x)	3.5	2.9	2.2	2.1	1.9
RoE (%)	12.6	6.2	NM	4.5	13.5
RoCE (%)	10.3	6.7	NM	5.0	11.6
Dividend yield (%)	0.1	0.8	0.1	0.4	0.6
Net debt / equity (x)	0.3	0.4	0.4	0.4	0.4

Source: Company, Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Net revenues	10,968	10,453	9,685	11,323	13,635
Growth (%)	8.8	-4.7	-7.4	16.9	20.4
Direct costs	3,613	3,512	3,203	3,657	4,404
SG&A	5,790	5,592	5,715	6,420	7,063
EBITDA	1,565	1,349	767	1,246	2,168
EBITDA margins (%)	14.3	12.9	7.9	11.0	15.9
- Depreciation	633	677	716	719	797
Other income	40	47	61	68	74
Interest expenses	62	235	205	208	210
PBT	909	484	-93	386	1,235
Effective tax rate (%)	15.3	15.0	68.9	21.0	21.0
+ Associates / (Minorities)					
Net income	771	412	-29	305	975
Adjusted income	771	412	-29	305	975
WANS	92	92	92	92	92
FDEPS (₹ / sh)	8.4	4.5	-0.3	3.3	10.6
R&D (% of sales)	4.7	5.1	5.3	4.2	4.3

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
PBT (adj. other inc. / int.)	932	672	51	527	1,371
+ Non-cash items	633	677	716	719	797
Oper. prof. before WC	1,565	1,349	767	1,246	2,168
- Incr. / (decr.) in WC	725	-208	-573	527	1,057
Others incl. taxes	55	111	8	81	259
Operating cash-flow	784	1,447	1,331	637	852
- Capex (tang. + intang.)	1,654	1,616	1,002	527	549
Free cash-flow	-869	-169	329	110	303
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	22	177	33	73	235
+ Equity raised	-	-	-0	-	-
+ Debt raised	1,397	25	143	35	35
- Fin investments	-157	-	-0	-	-
- Misc. (CFI + CFF)	163	185	195	141	136
Net cash-flow	500	-507	244	-69	-33

Source: Company, Anand Rathi Research

Fig 5 – Price movement


Source: Bloomberg

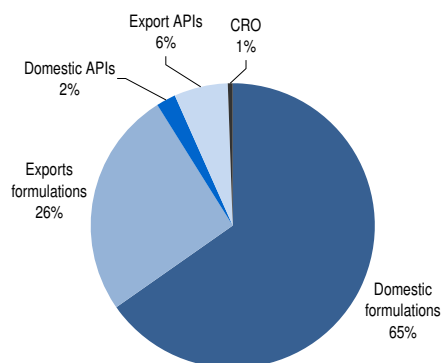
Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Share capital	184	184	184	184	184
Net worth	6,513	6,750	6,606	6,838	7,578
Debt	2,795	2,820	2,963	2,998	3,033
Minority interest	0	0	-	-	-
DTL / (Assets)	-276	-313	-355	-355	-355
Capital employed	9,033	9,257	9,214	9,481	10,256
Net tangible assets	3,928	4,411	4,166	3,967	3,690
Net intangible assets	470	477	509	514	540
Goodwill	1	1	1	1	1
CWIP (tang. & intang.)	906	1,356	1,854	1,856	1,860
Investments (strategic)	0	0	0	0	0
Investments (financial)	-	-	-	-	-
Current assets (ex cash)	5,760	5,703	5,332	6,098	7,278
Cash	626	119	363	293	260
Current liabilities	2,659	2,809	3,011	3,250	3,373
Working capital	3,101	2,893	2,321	2,848	3,905
Capital deployed	9,033	9,257	9,214	9,481	10,256
Contingent liabilities	866	527	251	-	-

Fig 4 – Ratio analysis

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
P/E (x)	29.9	47.2	NM	48.1	15.0
EV / EBITDA (x)	16.1	16.4	22.5	13.9	8.0
EV / Sales (x)	2.3	2.1	1.8	1.5	1.3
P/B (x)	3.5	2.9	2.2	2.1	1.9
RoE (%)	12.6	6.2	NM	4.5	13.5
RoCE (%) - after tax	10.3	6.7	0.4	5.0	11.6
ANDA filings	30	48	46.0	-	-
DPS (₹ / sh)	0.2	1.6	0.3	0.7	1.0
Dividend yield (%)	0.1	0.8	0.1	0.4	0.6
Dividend payout (%) - incl. DDT	2.9	43.1	NM	24.1	24.1
Net debt / equity (x)	0.3	0.4	0.4	0.4	0.4
Receivables (days)	72	73	74	73	73
Inventory (days)	62	68	69	70	72
Payables (days)	55	52	64	62	55
CFO : PAT %	101.8	351.5	NM	209.0	87.3

Source: Company, Anand Rathi Research

Fig 6 – Revenue break-up (Q2 FY20)


Source: Company

Result Highlights

Fig 7 – Quarterly financials

(₹ m)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	% Y/Y	% Q/Q	H1 FY19	H1 FY20	% Y/Y
Sales	2,178	2,360	2,626	2,521	2,527	2,926	24.0	15.8	4,538	5,453	20.2
Gross profit	1,465	1,564	1,743	1,709	1,671	2,030	29.8	21.5	3,029	3,701	22.2
Gross margins (%)	67.3	66.3	66.4	67.8	66.1	69.4	312bps	326bps	66.7	67.9	112bps
R&D expenses	132	128	124	131	111	116	(8.7)	4.7	260	228	(12.3)
EBITDA	114	121	248	284	224	326	169.0	45.5	235	551	133.9
EBITDA margins (%)	5.2	5.1	9.4	11.3	8.9	11.2	601bps	228bps	5.2	10.1	491bps
Interest	72	50	37	46	61	54	7.2	(12.3)	122	115	(5.7)
Depreciation	167	176	177	195	170	180	2.3	6.2	344	350	1.9
Other income	3	3	6	50	6	6	70.6	(9.4)	6	12	90.6
PBT	(122)	(102)	39	93	(0)	98.0	NM	NM	(224)	98	NM
Tax	-	(27)	(14)	(22)	(19)	20	NM	NM	(27)	1	NM
Effective tax rate (%)	-	26.8	(36.9)	(24.2)	3,800.0	NM	NM	NM	12.2	0.9	NM
Adjusted PAT	(122)	(75)	53	115	19	78	NM	322.2	(197)	97	NM

Source: Company, Anand Rathi Research

Fig 8 – Revenue break-up

(₹ m)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	% Y/Y	% Q/Q	H1 FY19	H1 FY20	% Y/Y
Formulations	1,911	2,118	2,210	2,158	2,209	2,604	23.0	17.9	4,029	4,813	19.5
India	1,497	1,590	1,525	1,450	1,616	1,863	17.2	15.3	3,087	3,479	12.7
Exports	414	528	685	707	593	741	40.3	25.0	943	1,335	41.6
Regulated markets	294	363	482	470	432	516	42.1	19.5	657	948	44.3
Semi-regulated markets	120	165	204	237	161	225	36.4	39.6	285	386	35.4
API	158	191	222	251	237	234	22.2	(1.6)	349	471	34.9
India	83	60	80	97	86	63	5.0	(27.7)	143	149	4.2
Outside India	75	132	142	154	151	171	29.9	13.4	206	322	56.2
CRO	56	50	47	42	26	18	(63.9)	(29.7)	106	44	(58.8)
Other operating Income	50	(3)	146	71	55	64	(2,375.0)	16.0	48	119	149.2
Total revenue	2,175	2,356	2,626	2,520	2,527	2,920	23.9	15.6	4,532	5,446	20.2

Source: Company, Anand Rathi Research

Fig 9 – Domestic formulations (₹ m)

Therapy	Q2 FY19	Q2 FY20	% Y/Y
Anti-infectives	258	343	32.8
Stomatologicals	283	329	16.3
Respiratories	255	318	24.6
Gastrointestinals	217	268	23.6
Vitamins / minerals / nutraceuticals	124	113	-8.7
Ophthal / Otorologicals	100	106	5.9

Source: Company, Anand Rathi Research

Fig 10 – Revenue from major brands (₹ m)

Brands	Q2 FY19	Q2 FY120	% Y/Y
Cyclopam	164	210	28.1
Febrex Plus	144	198	37.3
Oxipod	96	136	42.4
ATM	79	117	47
Cital	80	107	32.7
Sensodent K	87	103	18.9
Cloben G	57	58	2.6
Sensoform	50	55	10.8
Karvol	44	52	17.6
Sensodent KF	47	51	7.4
Bactogard	32	43	36
Tuspel	40	42	4.5
Carmicide	27	32	18.9
Rexidin	20	31	54.2
Kidodent	25	30	19.1

Source: Company, Anand Rathi Research

Fig 11 – Sales break-up

Particulars (₹ m)	FY19	FY20e	FY21e
Formulations	8,397	9,848	11,853
% growth	-10.9	17.3	20.4
% of total sales	91.1	90.5	89.9
Domestic	6,062	6,789	7,604
% growth	1.9	12.0	12.0
% of formulations	72.2	68.9	64.2
Exports	2,335	3,059	4,249
% growth	-32.8	31.0	38.9
% of formulations	27.8	31.1	35.8
Regulated markets	1,609	2,245	3,338
% growth	-41.6	39.6	48.7
Semi-regulated markets	727	814	911
% growth	1.3	12.0	12.0
APIs	822	1,036	1,331
% growth	35.1	26.0	28.4
% of total sales	8.9	9.5	10.1
Domestic	320	332	346
% growth	31.5	4.0	4.0
% of APIs	38.9	32.1	26.0
Exports	503	704	985
% growth	37.5	40.0	40.0
% of APIs	61.1	67.9	74.0
Total revenue	9,219	10,884	13,184

Source: Company

Fig 12 – Regulatory status in major markets

Plant	Dosage Form	Inspecting Authority	Last Inspection Date	Current Status
Goa Plant I	Liquid orals, solid orals, ointments, capsules	US FDA	17 th Jan—25 th Jan'19	A warning letter was received from the US FDA on 18 th Jul'19
		UK-MHRA	21 st May—23 rd May'19	A full GMP status has been reinstated for Plant I in September 2019
Goa Plant II & Goa Plant III	Ophthalmics, injectables & solid orals	US FDA	7th Oct—15th Oct'19	Successfully concluded the US FDA audit for its sterile manufacturing facility in Goa Plant II from 7 th Oct to 15 th Oct'19. This is the second successful pre-approval inspection (PAI) of this site in less than six months, which indicates steady progress in review of pending ANDAs. The inspection ended with two observations, neither related to data integrity or the core quality management system. The company will respond to the FDA within the stipulated time. The site continues to maintain its VAI status
		UK-MHRA	Sep'19	Inspection concluded two observations, none critical. Response to the UK-MHRA has been duly submitted.

Source: Company

Concall highlights; Key takeaways

- India business growth of ~17% was driven by price growth: 4%, new product introductions: 2% and the rest through volume growth.
- In Q2 FY20, the company launched one product in the chronic category. The number of new product launches in H1 FY20 was three ie, two in the chronic and one in the sub-chronic categories.
- Indoco recently received an ANDA approval for Rasagiline 0.5mg and 1mg tablets, filed from Plant III. The molecule is used to treat Parkinson's disease. The launch is planned in the last quarter of FY20.
- Regulated market revenue grew 42.1% y/y to ₹516m (the US: ₹111m, the EU: ₹393m, and South Africa/New Zealand/Australia together ₹13m).
- US revenue of ₹111m during the quarter included a major amount on account of a milestone payment from a client on an R&D project.
- The US FDA conducted an inspection for the bio-analytical part from 5th to 9th Aug'19, and for the clinical part from 14th to 18th Oct'19 at AnaCipher CRO, Hyderabad. Both these inspections were successfully concluded with zero 483s.
- Other expenses in the quarter were higher, including ₹120m on sales and promotion. The benefit of the latter will be seen in the next two quarters.
- Management talked of 2-3 ANDA filings in FY20 and 5-6 in FY21.
- Capex guidance: not more than ₹500m in FY20.

Valuations

We cut our FY20e EBITDA 18.5% on the higher-than-anticipated operating costs and, thereby, cut our PAT estimate 38%.

Fig 13 – Change in estimates

₹ m	Old estimates		New estimates		Change (%)	
	FY20e	FY21e	FY20e	FY21e	FY20e	FY21e
Revenue	11,671	13,832	11,323	13,635	(3.0)	(1.4)
EBITDA	1,529	2,199	1,246	2,168	(18.5)	(1.4)
PAT	492	992	305	975	(38.1)	(1.6)

Source: Anand Rathi Research

At the CMP of ₹159, the stock trades at 48x and 15x respective FY20e and FY21e earnings. We believe revenue from the US will resume from Q4 FY20, and the domestic formulations and EU businesses will recover. We maintain our Buy recommendation on the stock, with a target of ₹191 (earlier ₹194) based on 18x FY21e EPS.

Risks

- Currency fluctuations.
- Regulatory issues regarding any other plant.
- We expect supplies to the US to start from FY20. However, any further delay would pare our earnings estimate.

Fig 14 – Key data

	RATING	CMP (₹)	TP (₹)	M Cap (₹ bn)	PE (x)		PE (x) Bloomberg		EV / EBITDA		RoE (%)		RoCE (%)	
					FY20e	FY21e	FY20e	FY21e	FY20e	FY21e	FY20e	FY21e	FY20e	FY21e
Aarti	Buy	529	796	12.5	10.4	8.0	9.8	8.0	6.7	5.5	20.1	21.4	12.6	14.3
Ajanta	Hold	1,026	1,057	89.9	21.2	17.5	22.0	18.6	14.0	11.7	17.6	18.6	17.3	18.2
Alembic	Hold	542	624	102.3	14.5	15.7	17.4	16.3	10.3	10.3	23.6	18.6	17.9	14.9
Alkem	Buy	1974	2185	236.0	23.6	19.0	24.5	19.9	17.2	13.8	17.3	18.9	17.4	19.2
Cadila	Hold	250	266	256.2	17.1	16.0	16.0	14.1	10.9	10.0	13.8	13.4	9.0	9.0
Dishman	Buy	116	362	18.7	6.0	5.1	11.1	8.6	4.2	3.5	15.4	16.3	11.2	12.1
Eris	Buy	449	614	61.7	17.4	14.6	17.0	15.0	13.8	10.9	26.7	24.6	27.0	27.2
Granules India	Buy	129	172	32.8	10.4	9.0	9.0	7.6	7.4	5.9	18.9	18.3	12.0	13.6
Indoco Remedies	Buy	159	191	14.7	48.1	15.0	29.4	10.9	13.9	8.0	4.5	13.5	5.0	11.6
Ipca Labs.	Buy	983	1,107	124.2	22.2	17.8	20.8	16.6	14.1	11.3	16.6	17.7	14.5	15.9
JB Chemicals	Buy	333	464	26.7	11.4	10.0	12.3	10.7	6.2	5.3	15.2	16.0	14.6	15.4
Natco Pharma	Buy	587	763	106.7	15.4	16.9	16.7	16.5	11.9	12.5	18.4	14.6	17.0	13.7
Neuland	Buy	494	667	6.4	15.1	11.1	15.1	10.4	8.5	6.7	5.9	7.5	5.7	6.9
Pfizer	Hold	3900	3265	178.4	38.8	33.4	31.2	27.2	24.5	21.0	14.5	15.2	14.5	15.2
Suven Life Sciences	Buy	300	300	38.2	30.9	29.5	27.3	23.2	18.4	16.9	14.1	13.3	13.0	12.4
Torrent Pharma	Hold	1,795	1,768	303.8	32.2	24.6	32.3	24.7	15.5	13.2	18.9	22.0	13.2	17.0
HCG	Buy	111	213	9.8	NM	313.5	NM	NM	10.2	7.9	NM	0.7	3.5	5.3

Source: Company, Anand Rathi Research

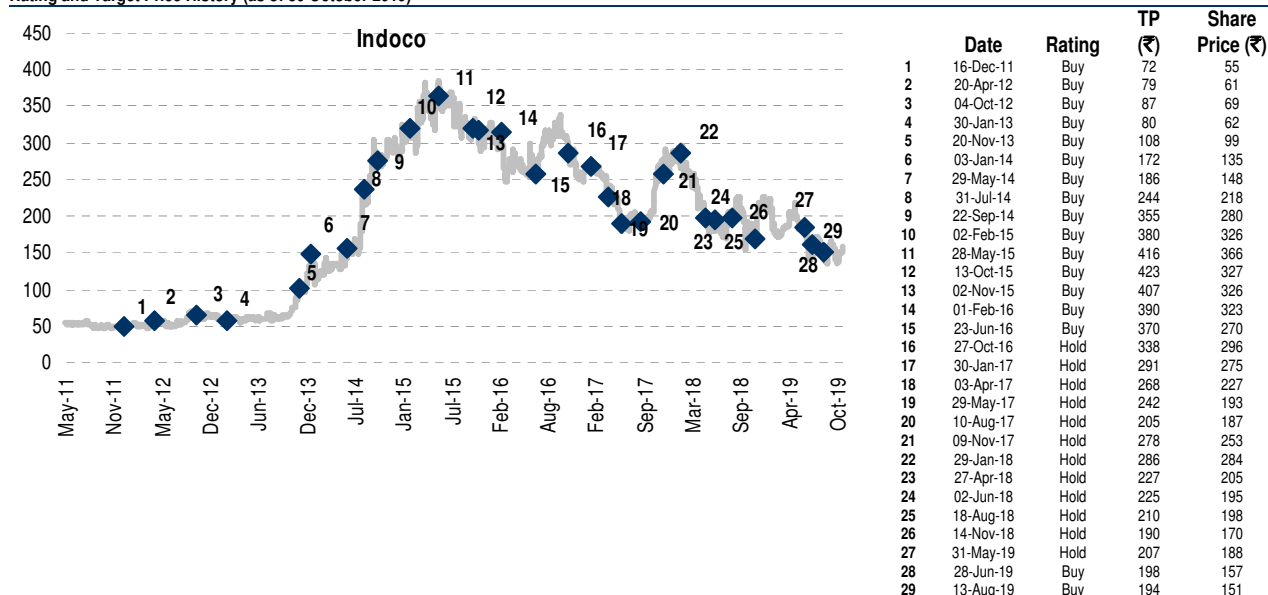
Appendix

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	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
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