

Indoco Remedies

24 January 2020

Reuters: INDR.BO; Bloomberg: INRMIN

Strong revenue growth and margin improvement

Indoco Remedies' (IRL) 3QFY20 revenue at Rs2,894mn is up 14.3% YoY (down 1.1% QoQ) and is higher than our/consensus estimate by 2.2%/0.1%, respectively. Net profit stood at Rs91mn (16.6% above expectation). Revenue growth was led by the domestic business and strong growth in regulated markets. Domestic business growth outperformed IPM and grew by 17% YoY. Indoco's ranking in the domestic market jumped one rank to 29th with a market share of 0.67%. Europe revenue posted strong growth and was up 18% QoQ. US revenue was also significantly higher at Rs160mn, driven by a one-time milestone income. Currently, only two products are being shipped to the US, which should expand to 6 as the company will launch 4 recently approved ANDAs.

The strong growth in regulated markets led by US and Europe was offset by subdued performance in South Africa/Australia as revenue sharply declined on account of regulatory inspections. Revenue from these geographies should start showing up from 1QFY21 as the company awaits outcome from the regulatory inspections. API business too declined as the in-house capacity was utilized for captive consumption for sales of formulations to the European markets. The API business growth should reinstate once commercial shipments from the new facility at Patalganga (3x of current capacity) are initiated (1QFY21).

The company hopes to deliver mid-teens growth in the domestic business in FY21. Growth drivers will be improved productivity for its chronic and sub-chronic therapy business where sales per MR is much below company average of Rs0.25mn per MR per month.

The EU business should continue impressive growth and is expected to ramp up at 30%-35% from a relatively subdued base.

In the US, the company expects 4 ANDA approvals per year going forward through partners as well as self-fillings. About 4 launches are also expected in the coming months, which should gain critical mass in volume by 2QFY21.

EBITDA at Rs349mn increased by 6.9% QoQ and 40.7% YoY and was above 7.0%/4.2% our/consensus estimates, respectively. EBITDA margin improved to 12.1%, up by 261bps YoY on account of positive contribution from the US business and higher gross margin (71%) which represents a 220bps improvement QoQ.

Outlook and Valuation: With regulatory woes largely corrected, the company's regulated market sales is back on growth track, led by strong recovery in Europe, which is now back to its base run rate of Rs450mn per quarter. The EU revenue growth will sustain, and the US and other regulated markets should also start meaningfully contributing FY21 onwards. Assuming no differentiated limited competition launches, the US business can incrementally add Rs1000mn to FY21 sales. The sales growth will happen with no incremental investment in employee or any other fixed cost and hence the margin contribution should be much higher. Considering the recent run-up in the stock price we revise our rating on IRL to Accumulate from Buy and maintain our target price of Rs239 based on risk adjusted 16x P/E to September FY21 EPS.

ACCUMULATE

Sector: Pharmaceutical

CMP: Rs234

Target Price: Rs239

Upside: 2%

Vishal Manchanda

Research Analyst

vishal.manchanda@nirmalbang.com

+91-9737437148

Gaurang Sakare

Research Associate

Gaurang.sakare@nirmalbang.com

+91-22 6273 8093

Key Data

Current Shares O/S (mn)	92.2
Mkt Cap (Rsbn/US\$m)	21.5/301.6
52 Wk H / L (Rs)	245/132
Daily Vol. (3M NSE Avg.)	114,226

Price Performance (%)

	1 M	6 M	1 Yr
Indoco Remedies	37.2	44.5	12.5
Nifty Index	(0.7)	7.5	12.5

Source: Bloomberg

Y/E March (Rsmn)	Q3FY19	Q2FY20	Q3FY20	YoY (%)	QoQ (%)	9MFY19	9MFY20	YoY (%)
Revenues	2,626	2,926	2,894	10.2	(1.1)	7,157	8,346	16.6
Raw material costs	882	896	828	(6.1)	(7.6)	2,391	2,580	7.9
% of revenues	33.6	30.6	28.6	(498) bps	(200) bps	33.4	30.9	(250) bps
Staff costs	589	641	682	15.9	6.4	1,735	1,933	11.4
% of revenues	22.4	21.9	23.6	115 bps	166 bps	24.2	23.2	(108) bps
R&D	124.4	116.4	129.1	3.8	10.9	384	357	(7.1)
% of revenues	4.7	4.0	4.5	(28) bps	48 bps	5.4	4.3	(109) bps
Other expenses	782	946	905	15.7	(4.3)	2,166	2,577	19.0
% of revenues	29.8	32.3	31.3	149 bps	(104) bps	30.3	30.9	62 bps
EBITDA	248	326	349	40.7	6.9	482	899	86.7
EBITDA margin (%)	9.4	11.2	12.1	261 bps	90 bps	6.7	10.8	404 bps
Other income	6	6	7	26.3	24.1	12	19	60.3
Interest costs	37	54	69	86.3	29.1	159	184	15.8
Depreciation	177	180	176	(0.8)	(2.5)	521	526	1.0
PBT	39	98	111	183.8	13.0	(186)	208	-
Tax	(14)	20	20	(236.8)	(1.0)	(42)	21	-
Tax rate (%)	-	20.3	17.8	5472 bps	(251) bps	22.4	9.9	-
Reported PAT	53	78	91	70.4	16.5	(145)	188	-

Source: Company, Nirmal Bang Institutional Equities Research

Earnings conference-call commentary

Europe revenue trajectory going forward: Expect Europe sales to sustain its current growth trajectory and grow at 30-35%.

Higher other expenses: Other expenses include remediation costs which were about Rs80mn for the nine months ending FY20.

Employee cost: Employee cost is up Rs40mn QoQ. Arrears related to increments were booked during the quarter. Current total employee strength is 6,000.

US: US revenue was Rs161mn during the quarter. The QoQ increase of Rs40mn in US sales was driven by milestone income. Expect US to do Rs1000mn in FY21 (not including revenue from differentiated launches).

Australia and New Zealand: Sales declined during the quarter as there were regulatory issues. These geographies are primarily being supplied from Unit I. Expect regulatory issues to be resolved from 1QFY21 onwards.

Gross margin at 71%: Gross margin improvement was driven by business mix and control over raw material costs through higher contribution of in-house captive API. US sales would be accretive to margins.

India business: Going forward, US product pipeline in the cardio diabetic category will be leveraged for India market. Current MR strength in India stands at 2300 and should stay at current level in the near future. About half of MR is into acute business, while the rest are into chronic and sub-chronic space. There is a scope of improving return per MR which stands at Rs2.3mn currently.

ANDA filings: The company intends to file 5 ANDAs in FY21.

ANDA launches: 3-4 ANDA launches are expected in 4QFY20 and these should gain reasonable volume around 2QFY21. Expect additional 4 approvals in the US in FY21 (does not include any product approvals from Unit I).

R&D spend: The total R&D spends during the quarter was 6.5% of the revenue and out of which 2% is capitalized.

API: Sales declined during the quarter due to an increase in API captive consumption, which was led by Europe sales. The new API capacity will be commercialized in 2-3 quarters from now and would allow API sales to improve from the current level.

Debt: Total debt is Rs2610mn (Rs1600mn long term) and finance cost during the quarter included Rs10mn of forex loss.

Free cash flow: The company has generated Rs450mn FCF in 9 months ending FY20.

Exhibit 1: Key financials

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net sales	10,453	9,685	12,054	14,739	16,619
EBITDA	1,349	767	1,554	2,670	3,046
Net profit	412	(29)	457	1,238	1,523
EPS (Rs)	4.5	(0.3)	5.0	13.4	16.5
EPS growth (%)	(46.6)	(107.0)	(1,676.3)	170.8	23.0
EBITDA margin (%)	12.9	7.9	12.9	18.1	18.3
P/E (x)	52.3	-742.0	47.1	17.4	14.1
P/BV (x)	3.2	3.3	3.1	2.7	2.3
EV/EBITDA (x)	17.6	30.8	15.4	8.8	7.4
RoCE (%)	9.0	0.3	10.0	22.1	23.1
RoE (%)	6.2	-0.4	6.8	16.7	17.7

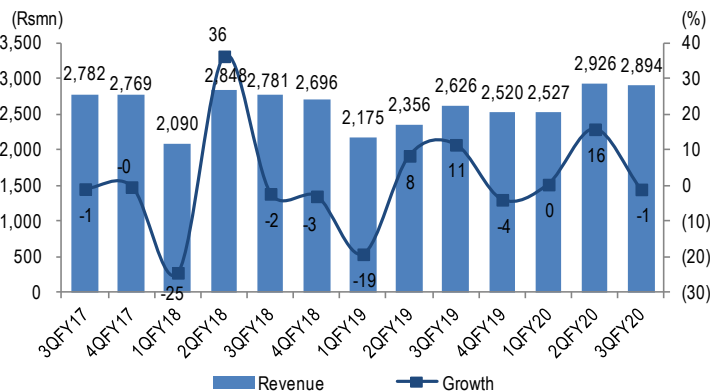
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Actual versus our estimates

(Rsmn)	Actual	Our est.	Var. (%)	Cons.	Var (%)
Revenues	2,894	2,830	2.2	2,890	0.1
EBITDA	349	326	7.0	335	4.2
EBITDA margin (%)	12.1	11.5	54 bps	11.6	47 bps
PAT	91	78	16.6	95	(4.2)

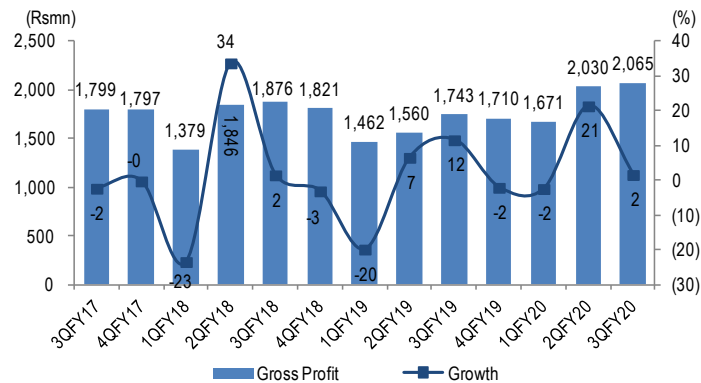
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Revenue and growth trend



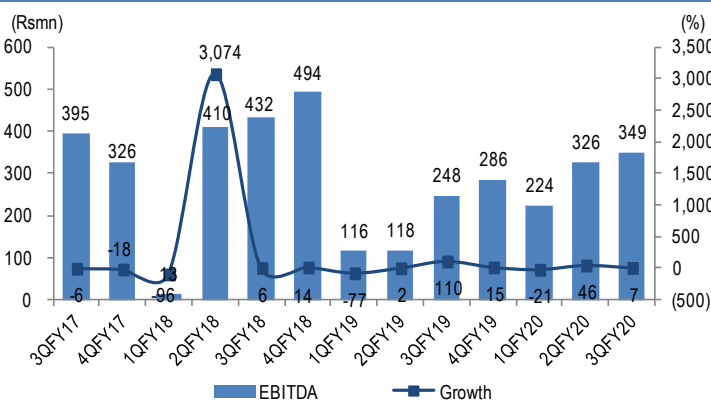
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Gross profit and growth trend



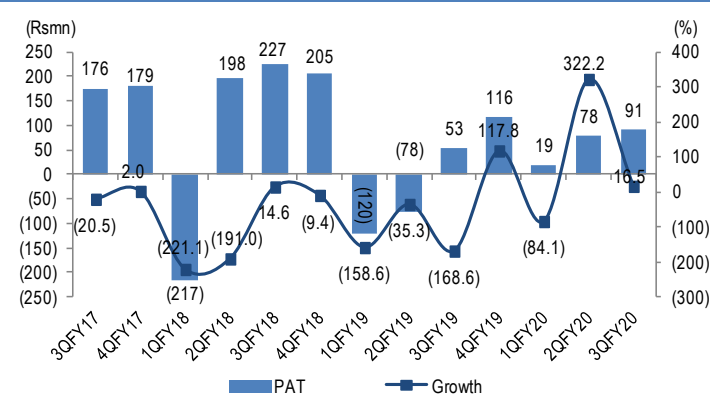
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: EBITDA and growth trend



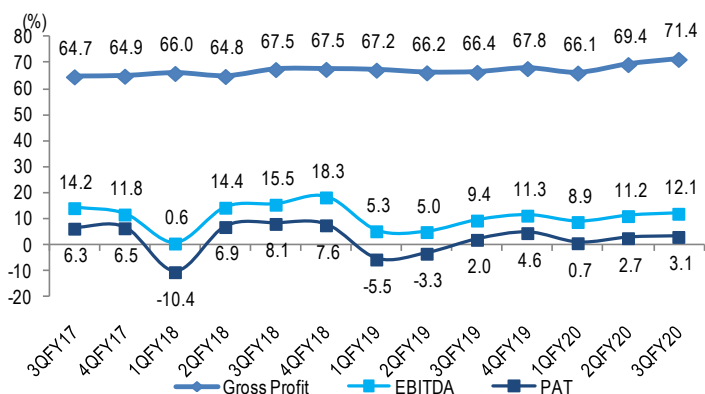
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: PAT and growth trend



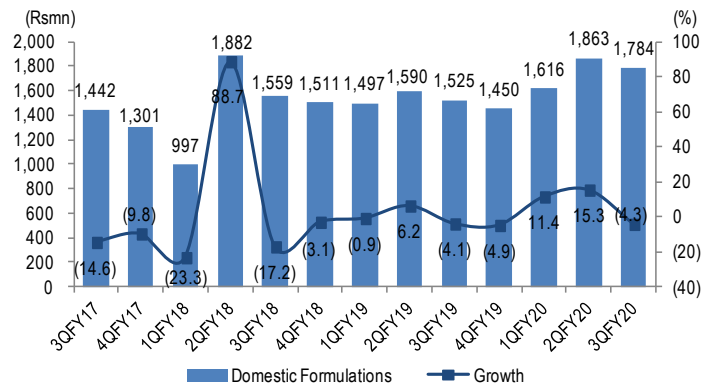
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Margin trend

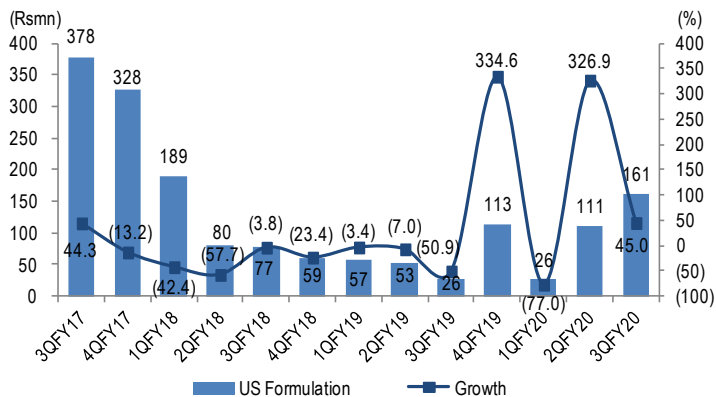


Source: Company, Nirmal Bang Institutional Equities Research

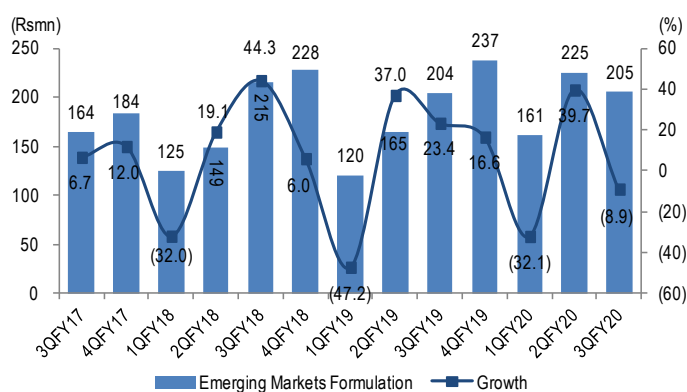
Exhibit 8: Domestic formulations revenue and growth trend



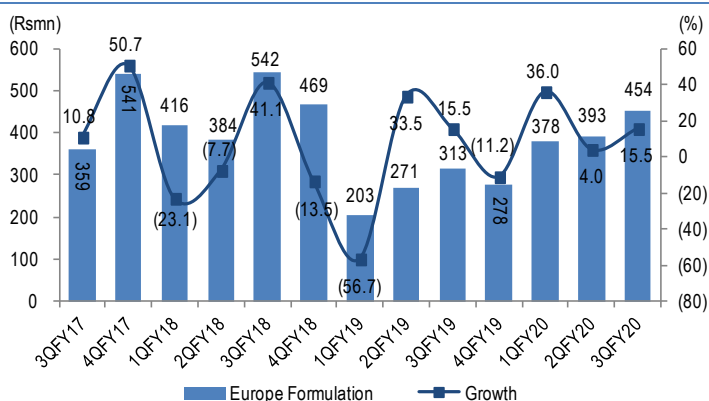
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: US formulations revenue and growth trend


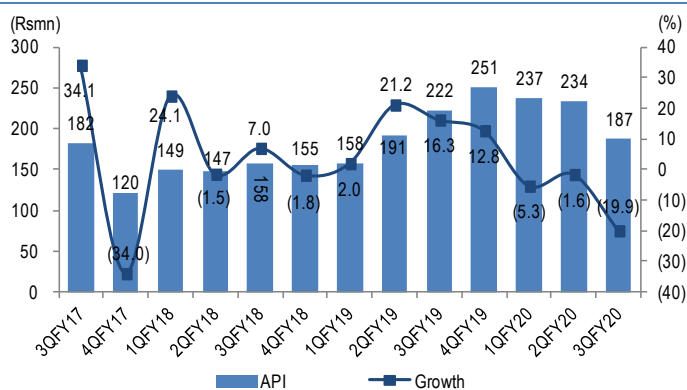
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: EM formulations revenue and growth trend


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Europe formulations revenue and growth trend


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: API revenue and growth


Source: Company, Nirmal Bang Institutional Equities Research

Financial statements

Exhibit 13: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net sales	10,453	9,685	12,054	14,739	16,619
% growth	-4.7	-7.4	24.5	22.3	12.8
Raw material expenses	3,512	3,203	4,215	5,139	5,808
Staff costs	2,209	2,317	2,548	2,803	3,111
R&D expenses	535	515	663	737	831
Other expenses	2,848	2,884	3,074	3,390	3,822
Total expenditure	9,104	8,918	10,500	12,069	13,572
EBITDA	1,349	767	1,554	2,670	3,046
% growth	-13.8	-43.2	102.7	71.8	14.1
EBITDA margin (%)	12.9	7.9	12.9	18.1	18.3
Other income	47	61	27	13	70
Interest costs	235	205	216	242	261
Gross profit	6,941	6,482	7,839	9,600	10,811
% growth	-2.7	-6.6	20.9	22.5	12.6
Depreciation	677	716	755	790	824
Profit before tax	484	-93	610	1,651	2,031
% growth	-46.8	-119.2	-754.7	170.8	23.0
Tax	72	-64	152	413	508
Effective tax rate (%)	15.0	68.9	25.0	25.0	25.0
Net profit	412	-29	457	1,238	1,523
% growth	-46.6	-107.0	-	170.8	23.0
EPS (Rs)	4.5	-0.3	5.0	13.4	16.5
% growth	-46.6	-107.0	-	170.8	23.0

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Balance sheet

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Equity	184	184	184	184	184
Reserves	6,566	6,422	6,701	7,761	9,107
Net worth	6,750	6,606	6,885	7,946	9,291
Provisions/ other LT liabilities	224	233	258	297	332
Total loans	2,332	2,421	2,548	2,854	3,073
Liabilities	9,306	9,259	9,691	11,097	12,696
Net block	4,411	4,166	4,729	4,812	4,861
Capital work-in-progress	758	1,412	450	450	450
Intangible assets	486	510	478	478	478
LT loans & advances	11	13	13	13	13
Other LT assets	1,333	1,099	1,310	1,310	1,310
Inventories	1,934	1,835	2,321	2,830	3,198
Debtors	2,078	1,958	2,397	2,931	3,304
Cash	119	363	169	928	2,081
Other current assets	1,242	1,225	1,431	1,749	1,971
Total current assets	5,373	5,381	6,317	8,437	10,555
Trade payables	1,496	1,707	1,795	2,188	2,473
Other current liabilities/provisions	1,570	1,614	1,811	2,214	2,496
Total current liabilities	3,066	3,321	3,605	4,402	4,969
Net current assets	2,307	2,059	2,712	4,035	5,585
Total assets	9,305	9,259	9,691	11,097	12,696

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Cash flow

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
EBIT	719	112	826	1,893	2,292
(Inc./)dec. in working capital	178	492	(846)	(564)	(397)
Cash flow from operations	897	604	(20)	1,329	1,894
Other income	(47)	(61)	(27)	(13)	(70)
Depreciation	677	716	755	790	824
Interest	(235)	(205)	(216)	(242)	(261)
Tax paid (-)	(72)	64	(152)	(413)	(508)
Net cash from operations	1,220	1,117	339	1,452	1,880
Capital expenditure (-)	(1,242)	(859)	(84)	(600)	(600)
Net cash after capex	(22)	258	255	852	1,280
Other investing activities	(131)	(3)	(424)	(260)	(203)
Cash from financial activities	(353)	(17)	(25)	168	75
Change in cash balance	(506)	238	(194)	760	1,153
Opening cash balance	626	119	363	169	928
Closing cash balance	120	357	169	928	2,081

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Key ratios

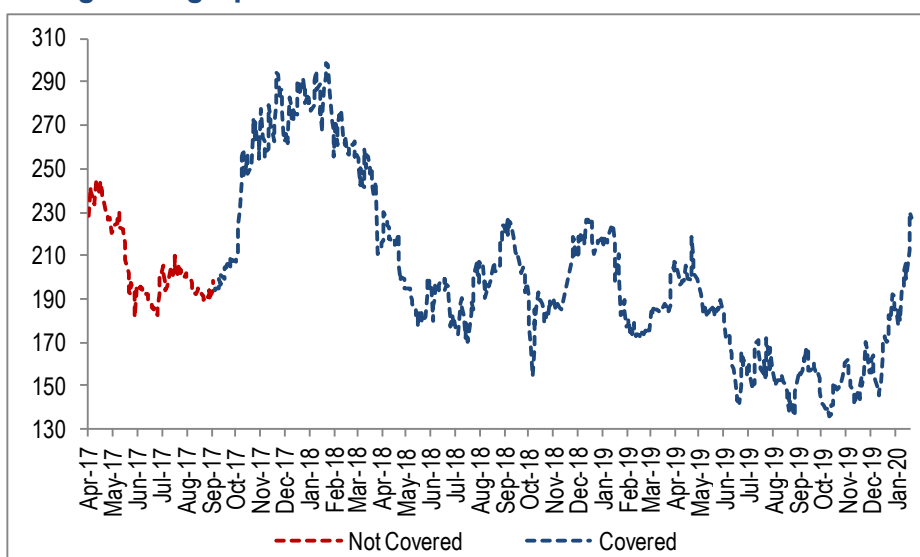
Y/E March	FY18	FY19	FY20E	FY21E	FY22E
Profitability & return ratios					
EBITDA margin (%)	12.9	7.9	12.9	18.1	18.3
EBIT margin (%)	6.4	0.5	6.6	12.8	13.4
Net profit margin (%)	3.9	(0.3)	3.8	8.4	9.2
RoE (%)	6.2	(0.4)	6.8	16.7	17.7
RoCE (%)	9.0	0.3	10.0	22.1	23.1
Working capital & liquidity ratios					
Receivables (days)	74	76	66	66	68
Inventory (days)	198	215	180	183	189
Payables (days)	163	183	152	141	146
Working capital days	109	108	94	107	111
Current ratio (x)	1.8	1.6	1.8	1.9	2.1
Quick ratio (x)	1.1	1.1	1.1	1.3	1.5
Valuation ratios					
EV/Sales (x)	2.3	2.4	2.0	1.6	1.4
EV/EBITDA (x)	17.6	30.8	15.4	8.8	7.4
P/E (x)	52.3	NA	47.1	17.4	14.1
P/BV (x)	3.2	3.3	3.1	2.7	2.3

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
5 September 2017	Buy	194	250
8 November 2017	Buy	256	295
29 January 2018	Accumulate	296	315
31 May 2018	Buy	200	301
14 August 2018	Buy	196	301
14 November 2018	Buy	179	273
5 April 2019	Buy	208	289
30 May 2019	Buy	187	290
14 August 2019	Buy	151	290
23 September 2019	Buy	158	300
31 October 2019	Buy	159	239
24 January 2020	Buy	234	239

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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Team Details:			
Name		Email Id	Direct Line
Rahul Arora	CEO	rahul.arora@nirmalbang.com	-
Girish Pai	Head of Research	girish.pai@nirmalbang.com	+91 22 6273 8017 / 18
Dealing			
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 6273 8230, +91 22 6636 8833
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 6273 8102/8103, +91 22 6636 8830

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address

B-2, 301/302, Marathon Innova,
 Nr. Peninsula Corporate Park,
 Lower Parel (W), Mumbai-400013.

Board No. : 91 22 6273 8000/1; Fax. : 022 6273 8010