

## Ipsca Laboratories

### Performance Highlights

Y/E March (` cr)	2QFY2018	1QFY2018	% chg (QoQ)	2QFY2017	% chg (YoY)
<b>Net sales</b>	<b>864</b>	<b>713</b>	<b>21.2</b>	<b>884</b>	<b>(2.3)</b>
Other income	11	6	78.0	6	77.7
Operating profit	149	22	592.5	135	10.2
Tax	13	(1)	-	37	(64.9)
<b>Adj. net profit/(loss)</b>	<b>96</b>	<b>(20)</b>	<b>-</b>	<b>55</b>	<b>75.6</b>

Source: Company, Angel Research

IPCA Labs posted results lower than expected for 2QFY2018 mainly on the OPM and net profit front. In sales, the company posted sales of `864cr, a yoy de-growth of 2.3% v/s. `884cr for 2QFY2017, but mostly in line with the expected sales of `870cr. On OPM front, the company posted EBITDA of 17.2% (v/s. 20.5% expected) v/s. 15.3% in 2QFY2017. Consequently, the company posted a profit of `96cr (v/s. PAT of `109cr expected) v/s. PAT of `55cr in 2QFY2017. **We recommend Accumulate with a target of `570.**

**Results below expectations:** In sales, the company posted sales of `864cr, a yoy de-growth of 2.3% v/s `884cr for 2QFY2017, but mostly in line with the expected `870cr sales. The sales dip was mainly on back of the Formulations (`659cr) sales, which posted a yoy de-growth of 3.0%, while API (`194cr) posted a yoy growth of 3.0% yoy. On OPM front, the company posted EBITDA of 17.2% (v/s. 20.5% expected) v/s. 15.3% in 2QFY2017. Consequently, the company posted a profit of `96cr (v/s. PAT of `109cr expected) v/s. PAT of `55cr in 2QFY2017.

**Outlook and Valuation:** We expect net sales to post a CAGR of 6.6% to `3,647cr and EPS to register a CAGR of 28.4% to `25.4 over FY2017-19E. The company's financials will be impacted by the USFDA import alert on the Ratlam, Indore and Silvassa facilities. However, given the comfortable valuations, **we recommend our Accumulate rating.**

#### Key financials (Consolidated)

Y/E March (` cr)	FY2016	FY2017	FY2018E	FY2019E
<b>Net sales</b>	<b>2,844</b>	<b>3,211</b>	<b>3,256</b>	<b>3,647</b>
% chg	(8.7)	12.9	1.4	12.0
<b>Adj. Net profit</b>	<b>133</b>	<b>195</b>	<b>205</b>	<b>321</b>
% chg	(47.6)	46.0	5.1	56.9
<b>EPS</b>	<b>10.6</b>	<b>15.4</b>	<b>16.2</b>	<b>25.4</b>
EBITDA margin (%)	10.6	13.9	14.1	17.1
P/E (x)	50.5	34.6	32.9	21.0
RoE (%)	5.9	8.2	8.0	11.5
RoCE (%)	4.1	8.7	8.6	13.3
P/BV (x)	2.9	2.7	2.5	2.3
EV/Sales (x)	2.5	2.2	2.1	1.8
EV/EBITDA (x)	23.5	16.0	15.1	10.8

Source: Company, Angel Research; Note: CMP as of November 27, 2017

## ACCUMULATE

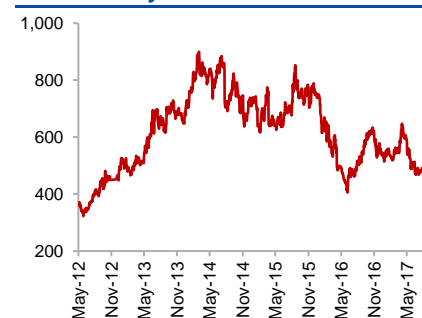
CMP	`533
Target Price	`570
Investment Period	12 Months

Stock Info	
Sector	Pharmaceutical
Market Cap (` cr)	6,732
Net Debt (` cr)	357
Beta	0.5
52 Week High / Low	656/400
Avg. Daily Volume	31,324
Face Value (`)	2
BSE Sensex	33,724
Nifty	10,400
Reuters Code	IPCA.BO
Bloomberg Code	IPCA@IN

Shareholding Pattern (%)	
Promoters	46.1
MF / Banks / Indian FIs	25.0
FII / NRIs / OCBs	17.1
Indian Public / Others	11.8

Abs. (%)	3m	1yr	3yr
Sensex	6.2	28.0	18.6
Ipsca	28.0	(6.2)	(21.4)

#### 3-Year Daily Price Chart



Source: Company, Angel Research

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**Exhibit 1: 2QFY2018 – Standalone performance**

Y/E March (` cr)	2QFY2018	1QFY2018	% chg (QoQ)	2QFY2017	% chg (YoY)	1HFY2018	1HFY2017	% chg (yoy)
<b>Net sales</b>	<b>864</b>	<b>713</b>	<b>21.2</b>	<b>884</b>	<b>(2.3)</b>	<b>1577</b>	<b>1739</b>	<b>(9.3)</b>
Other income	11	6	78.0	6.19	77.7	17	11	55.3
<b>Total income</b>	<b>875</b>	<b>719</b>	<b>21.7</b>	<b>891</b>	<b>(1.7)</b>	<b>1594</b>	<b>1750</b>	<b>(8.9)</b>
Gross profit	569	445	27.8	565	0.8	1015	1106	(8.3)
<b>Gross margins (%)</b>	<b>65.9</b>	<b>62.5</b>		<b>63.9</b>		<b>64.3</b>	<b>63.6</b>	
Operating profit	149	22	592.5	135	10.2	171	255	(33.2)
<b>Operating margin (%)</b>	<b>17.2</b>	<b>3.0</b>		<b>15.3</b>		<b>10.8</b>	<b>14.7</b>	
Interest	6	6	14.5	6	4.6	12	12	(2.2)
Depreciation	44	43	1.6	43	2.6	87	85	2.7
PBT	110	(21)		92	-	88	169	(47.7)
Provision for taxation	13	(1)		37		12	66	(81.7)
Less: Excep. Items (gains)/ loss	0	0		0		0	0	
<b>Reported Net profit</b>	<b>96</b>	<b>(20)</b>		<b>55</b>	<b>75.6</b>	<b>76</b>	<b>103</b>	<b>(25.7)</b>
<b>Adj. Net profit/(loss)</b>	<b>96</b>	<b>(20)</b>		<b>55</b>	<b>75.6</b>	<b>76</b>	<b>103</b>	<b>(25.7)</b>
<b>EPS (`)</b>	<b>7.6</b>	<b>-</b>		<b>4.4</b>		<b>6.0</b>	<b>8.1</b>	

Source: Company, Angel Research, FY numbers are consolidated

**Exhibit 2: 2QFY2018 – Actual vs Angel estimates**

(` cr)	Actual	Estimates	Variation (%)
<b>Net sales</b>	<b>864</b>	<b>870</b>	<b>(0.7)</b>
Other income	11	6	78.0
Operating profit	149	179	(16.5)
Interest	6	6	14.5
Tax	13	27	(51.7)
<b>Adjusted Net profit/(loss)</b>	<b>96</b>	<b>109</b>	<b>(11.2)</b>

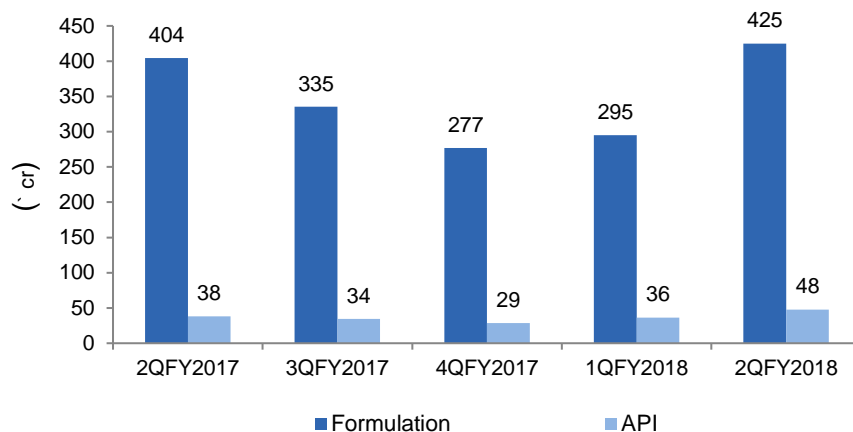
Source: Company, Angel Research

**Revenues 2.3% yoy dip mostly in line with our estimates:** The formulation sales (`864cr) posted a yoy de-growth of 3.0%, while API (`194cr) posted a yoy growth of 3.0%.

Domestic formulation sales (`425cr) posted a yoy growth of 3%, while exports formulation sales (`234cr) posted a yoy de-growth of 11.0%. Domestic API sales (`47cr) posted a growth of 16% yoy and export API sales were almost flat at `146cr.

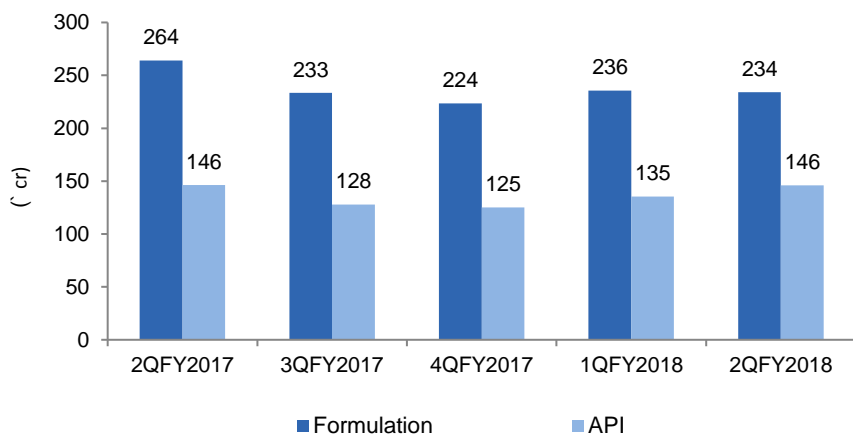
Overall, for 2QFY2018, exports contributed 44.6% to the top-line, while the domestic business contributed the rest. The overall contribution of formulations was at 77.3% of total sales during the quarter compared to 78.3% in 2QFY2017.

**Exhibit 3: Domestic sales trend**



Source: Company, Angel Research

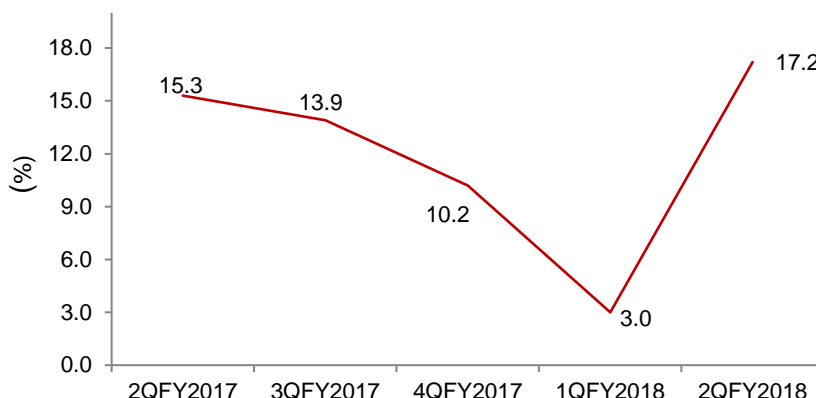
**Exhibit 4: Exports sales trend**



Source: Company, Angel Research

**OPM expands yoy, lower than expected:** On EBITDA front, the company posted EBITDA of 17.2% (v/s. 20.5% expected) v/s. 15.3% in 2QFY2017. The expansion in GPM to 65.9% in 2QFY2018 v/s. 63.9% in 2QFY2017, aided the OPM expansion.

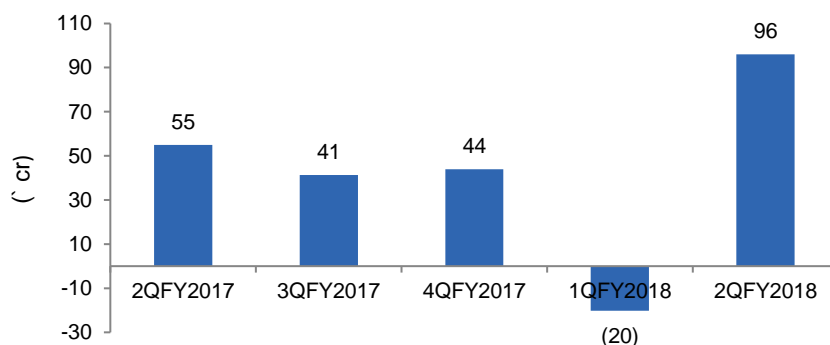
**Exhibit 5: OPM trend**



Source: Company, Angel Research

**Reported net profit:** Consequently, the Adj. net profit came in at `96cr (v/s. `109cr PAT expected) v/s. PAT of `55cr in 2QFY2017. The other income came in at `11cr v/s. `6.2cr in 2QFY2017.

**Exhibit 6: Adj. Net profit trend**



Source: Company, Angel Research

**Concall Highlights**

- Management expects growth to bounce back in domestic markets to low-to-mid-teens in coming quarters, led by channel re-filling.
- IPCA announced that Global Funds has selected the company as its panel supplier. At peak, institutional biz revenue was ~`400cr.
- IPCA has already invited USFDA for Piparia/Pithampur plants inspection. Company plans to invite the USFDA for re-inspection at Ratlam plant by CY2017 end/CY2018 beginning.
- EBITDA margin saw a negative impact of ~300bps from GST rollout.

## Investment arguments

- **Domestic formulations business – the cash-cow:** Ipca has been successful in changing its business focus to the high-margin chronic and lifestyle segments, from the low-margin anti-malarial segment. The chronic and lifestyle segments comprising CVS, anti-diabetics, pain-management, CNS and dermatology products constitute more than 50% of the company's domestic formulation sales. The Management has ramped up its field force significantly with addition of divisions in the domestic formulations segment, taking the current total strength to nearly 4,000 MRs. With an expected pick-up in sales in 2HFY2018 (after the GST impact reduces), we expect the domestic formulations business to grow at a CAGR of 10.9% over FY2017-19E.
- **Exports currently under pressure; should pick-up only by FY2019:** On the formulations front, Ipca has been increasing its penetration in regulated markets viz. Europe and the US, by expanding the list of generic drugs backed by its own API. In the emerging and semi-regulated markets, the company plans to focus on building brands in the CVS, CNS, pain-management and anti-malarial segments along with tapping new geographies. On the API front, where the company is among the low-cost producers, it is aggressively pursuing supply tie-ups with pharmaceutical MNCs.

After the USFDA inspection at the company's API manufacturing facility at Ratlam (Madhya Pradesh), the company has received certain inspection observations in Form 483, consequent to which the company had voluntarily decided to suspend API shipments from this manufacturing facility to the US markets until the issue is resolved. However, the Form 483 was converted into an import alert, except for four API's, which constituted around 45% of US sales in FY2014.

The company's Silvassa and Indore facilities (formulation facilities) are also under import alert. IPCA has already invited USFDA for Piparia/Pithampur plants inspection. Company plans to invite the USFDA for re-inspection at Ratlam plant by CY2017 end/CY2018 beginning. Thus, FY2019 should see some revival. We expect exports to grow at a CAGR of 2.4% over FY2017-19E.

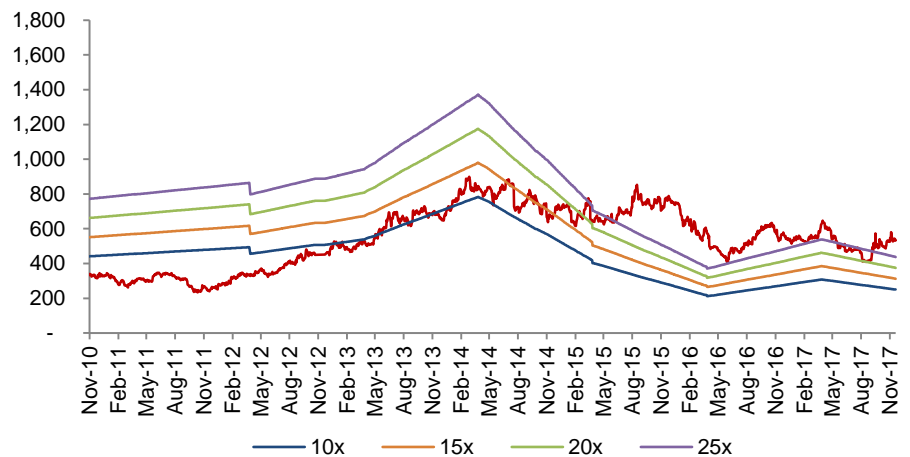
## Outlook & Valuation:

We expect net sales to post a CAGR of 6.6% to `3,647cr, and EPS to register a CAGR of 28.4% to `25.4cr over FY2017-19E. The company's financials will be impacted by the USFDA import alert on the Ratlam, Indore and Silvassa facilities. While the problems are likely to persist for a while, we expect a gradual pick-up in performance only by FY2019. However, given the valuations, **we maintain our Accumulate rating on the stock.**

**Exhibit 7: Key Assumptions**

	FY2018E	FY2019E
Sales growth (%)	9.0	11.8
Domestic growth (%)	8.0	14.0
Exports growth (%)	(4.6)	10.0
Operating margins (%)	14.1	17.1
Capex (` cr)	200	200

Source: Company, Angel Research

**Exhibit 8: One-year forward PE band**


Source: Company, Angel Research

**Exhibit 9: Recommendation summary**

Company	Reco.	CMP (`)	Tgt Price Upside			FY2019E			FY17-19E	FY2019E	
			(`)	(%)	(%)	PE (x)	EV/Sales (x)	EV/EBITDA (x)	CAGR in EPS (%)	RoCE (%)	RoE (%)
Alembic Pharma	Buy	513	600	16.9	21.5	2.5	13.0	5.7	20.6	18.4	
Aurobindo Pharma	Accumulate	719	823	14.4	14.0	2.2	10.2	14.2	25.3	22.7	
Cadila Healthcare	Reduce	444	411	(7.5)	21.7	3.5	17.7	18.9	16.5	22.2	
Cipla	Sell	615	462	(24.9)	25.3	2.7	16.1	39.3	10.9	13.1	
Dr Reddy's	Reduce	2,297	2,040	(11.2)	22.5	2.6	13.0	18.5	10.3	12.4	
Dishman Pharma	Under Review	301	-	-	19.3	2.7	11.5	23.3	4.5	4.4	
GSK Pharma*	Sell	2,463	2,000	(19.4)	53.6	6.3	39.7	19.3	25.8	23.5	
Indoco Remedies	Sell	285	136	(20.7)	25.0	2.2	11.7	16.2	10.1	14.5	
<b>Ipca labs</b>	<b>Accumulate</b>	<b>533</b>	<b>570</b>	<b>6.9</b>	<b>21.0</b>	<b>1.9</b>	<b>15.9</b>	24.7	12.4	11.0	
Lupin	Buy	831	1,091	31.2	16.8	2.0	9.4	(6.6)	13.7	13.7	
Sanofi India	Neutral	4,431	-	-	27.0	3.2	17.0	12.8	25.8	27.5	
Sun Pharma	Accumulate	550	615	11.8	24.7	3.7	16.6	(17.5)	11.3	14.0	

Source: Company, Angel Research; Note: \*December year ending

## **Company background**

Formed in 1949, Ipca Laboratories is a market leader in the anti-malaria's and rheumatoid arthritis segments. The company is a notable name in the domestic formulations category with 150 formulations across major therapeutic segments like cardiovascular (CVS), anti-diabetes, anti-malaria, pain-management (NSAID), anti-bacterial, central nervous system (CNS) and gastro-intestinal. The company has 7 production units, which are approved by most of the discerning regulatory authorities including USFDA, UKMHRA, Australia-TGA, South Africa-MCC and Brazil-ANVISA.

**Profit & loss statement (Consolidated)**

Y/E March (` cr)	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E
<b>Gross sales</b>	<b>3,232</b>	<b>3,157</b>	<b>2,891</b>	<b>3,262</b>	<b>3,308</b>	<b>3,706</b>
Less: Excise duty	33	40	47	51	52	58
<b>Net Sales</b>	<b>3,199</b>	<b>3,117</b>	<b>2,844</b>	<b>3,211</b>	<b>3,256</b>	<b>3,647</b>
Other operating income	82	40	41	23	23	23
<b>Total operating income</b>	<b>3,282</b>	<b>3,157</b>	<b>2,885</b>	<b>3,233</b>	<b>3,278</b>	<b>3,670</b>
% chg	16.7	(3.8)	(8.6)	12.1	1.4	12.0
Total expenditure	2,471	2,613	2,543	2,766	2,798	3,025
Net raw materials	1,137	1,155	1,058	1,110	1,042	1,204
Other mfg costs	250	277	253	286	290	325
Personnel	498	565	627	696	718	804
Other	587	616	606	674	749	693
<b>EBITDA</b>	<b>728</b>	<b>504</b>	<b>301</b>	<b>445</b>	<b>458</b>	<b>622</b>
% chg	29.1	(30.8)	(40.2)	47.7	2.9	35.9
(% of Net Sales)	22.8	16.2	10.6	13.9	14.1	17.1
Depreciation & amortisation	103	180	172	173	187	199
<b>EBIT</b>	<b>625</b>	<b>324</b>	<b>129</b>	<b>272</b>	<b>271</b>	<b>423</b>
% chg	31.1	(48.1)	(60.2)	110.8	(0.4)	56.3
(% of Net Sales)	19.5	10.4	4.5	8.5	8.3	11.6
Interest & other charges	27	28	32	24	21	10
Other Income	22	28	17	-	-	-
(% of PBT)	3.2	7.8	10.9	-	-	-
<b>Recurring PBT</b>	<b>703</b>	<b>364</b>	<b>155</b>	<b>270</b>	<b>273</b>	<b>436</b>
% chg	35.9	(48.2)	(57.5)	74.6	0.9	59.9
Extraordinary expense/(Inc.)	72.2	-	39.5	-	-	-
<b>PBT (reported)</b>	<b>631</b>	<b>364</b>	<b>115</b>	<b>270</b>	<b>273</b>	<b>436</b>
Tax	152.4	101.9	18.6	67.5	68.2	109.0
(% of PBT)	24.2	28.0	16.1	25.0	25.0	25.0
<b>PAT (reported)</b>	<b>478</b>	<b>262</b>	<b>97</b>	<b>203</b>	<b>205</b>	<b>327</b>
Add: Share of earnings of asso.	0	(5)	(3)	(8)	-	-
<b>PAT after MI (reported)</b>	<b>478</b>	<b>254</b>	<b>94</b>	<b>195</b>	<b>205</b>	<b>321</b>
<b>ADJ. PAT</b>	<b>495</b>	<b>254</b>	<b>133</b>	<b>195</b>	<b>205</b>	<b>321</b>
% chg	45.6	(48.6)	(47.6)	46.0	5.1	56.9
(% of Net Sales)	14.9	8.2	3.3	6.1	6.3	8.8
<b>Basic EPS (`)</b>	<b>39.2</b>	<b>20.1</b>	<b>10.6</b>	<b>15.4</b>	<b>16.2</b>	<b>25.4</b>
<b>Fully Diluted EPS (`)</b>	<b>39.2</b>	<b>20.1</b>	<b>10.6</b>	<b>15.4</b>	<b>16.2</b>	<b>25.4</b>
% chg	45.6	(48.6)	(47.6)	46.0	5.1	56.9



**Balance sheet (Consolidated)**

Y/E March (` cr)	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E
<b>SOURCES OF FUNDS</b>						
Equity share capital	25	25	25	25	25	25
Reserves & surplus	1,934	2,183	2,281	2,430	2,620	2,926
<b>Shareholders Funds</b>	<b>1,960</b>	<b>2,208</b>	<b>2,306</b>	<b>2,455</b>	<b>2,645</b>	<b>2,951</b>
Minority interest	-	-	-	-	-	-
Total loans	603	829	595	529	300	100
Other Long Term Liabilities	1	-	-	-	-	-
Long Term Provisions	15	22	23	26	26	26
Deferred tax liability	147	174	169	170	170	170
<b>Total Liabilities</b>	<b>2,726</b>	<b>3,233</b>	<b>3,094</b>	<b>3,181</b>	<b>3,142</b>	<b>3,248</b>
<b>APPLICATION OF FUNDS</b>						
Gross block	1,882	2,626	2,760	2,914	3,114	3,314
Less: Acc. depreciation	578	758	930	1,103	1,290	1,489
<b>Net Block</b>	<b>1,303</b>	<b>1,868</b>	<b>1,830</b>	<b>1,811</b>	<b>1,824</b>	<b>1,825</b>
Goodwill	50	34	102	102	102	102
Capital work-in-progress	165	165	165	165	165	165
<b>Investments</b>	<b>9</b>	<b>16</b>	<b>96</b>	<b>136</b>	<b>136</b>	<b>136</b>
Long Term Loans and Adv.	71	115	108	125	123	138
Current assets	1,602	1,614	1,522	1,620	1,626	1,816
Cash	76	125	162	36	13	15
Loans & advances	67	47	38	43	50	50
Other	1,459	1,442	1,322	1,542	1,563	1,751
<b>Current liabilities</b>	<b>485</b>	<b>579</b>	<b>729</b>	<b>779</b>	<b>835</b>	<b>935</b>
<b>Net Current Assets</b>	<b>1,117</b>	<b>1,035</b>	<b>793</b>	<b>842</b>	<b>792</b>	<b>881</b>
Other Non current Assets	9	-	-	.	.	.
<b>Total Assets</b>	<b>2,725</b>	<b>3,233</b>	<b>3,094</b>	<b>3,181</b>	<b>3,142</b>	<b>3,248</b>

**Cash flow statement (Consolidated)**

Y/E March (` cr)	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E
Profit before tax	631	364	115	270	273	436
Depreciation	103	180	172	173	187	199
(Inc)/Dec in working capital	(193)	88	286	(193)	29	(103)
Direct taxes paid	(152)	(102)	(19)	(68)	(68)	(109)
<b>Cash Flow from Operations</b>	<b>389</b>	<b>530</b>	<b>555</b>	<b>183</b>	<b>421</b>	<b>423</b>
(Inc.)/Dec.in fixed assets	(380)	(745)	(134)	(154)	(200)	(200)
(Inc.)/Dec. in Investments	-	-	-	-	-	-
<b>Cash Flow from Investing</b>	<b>(380)</b>	<b>(745)</b>	<b>(134)</b>	<b>(154)</b>	<b>(200)</b>	<b>(200)</b>
Issue of Equity	-	-	-	-	-	-
Inc./(Dec.) in loans	83	232	(232)	(63)	(229)	(200)
Dividend Paid (Incl. Tax)	(74)	(15)	(15)	(15)	(15)	(15)
Others	1	47	(69)	(77)	-	(6)
<b>Cash Flow from Financing</b>	<b>10</b>	<b>264</b>	<b>(316)</b>	<b>(155)</b>	<b>(244)</b>	<b>(221)</b>
Inc./(Dec.) in Cash	18	49	37	(126)	(23)	3
<b>Opening Cash balances</b>	<b>58</b>	<b>76</b>	<b>125</b>	<b>162</b>	<b>36</b>	<b>13</b>
<b>Closing Cash balances</b>	<b>76</b>	<b>125</b>	<b>162</b>	<b>36</b>	<b>13</b>	<b>15</b>

### Key Ratios

Y/E March	FY2014	FY2015	FY2016	FY2017	FY2018E	FY2019E
<b>Valuation Ratio (x)</b>						
P/E (on FDEPS)	13.6	26.5	50.5	34.6	32.9	21.0
P/CEPS	11.2	15.5	22.0	18.3	17.2	12.9
P/BV	3.4	3.0	2.9	2.7	2.5	2.3
Dividend yield (%)	0.9	0.2	0.2	0.2	0.2	0.2
EV/Sales	2.2	2.4	2.5	2.2	2.1	1.8
EV/EBITDA	9.9	14.6	23.5	16.0	15.1	10.8
EV / Total Assets	2.6	2.3	2.3	2.2	2.2	2.1
<b>Per Share Data (₹)</b>						
EPS (Basic)	39.2	20.1	10.6	15.4	16.2	25.4
EPS (fully diluted)	39.2	20.1	10.6	15.4	16.2	25.4
Cash EPS	47.4	34.4	24.2	29.1	31.0	41.2
DPS	5.0	1.0	1.0	1.0	1.0	1.0
Book Value	155.3	175.0	182.7	194.6	209.6	233.9
<b>DuPont Analysis</b>						
EBIT margin	19.5	10.4	4.5	8.5	8.3	11.6
Tax retention ratio	75.8	72.0	83.9	75.0	75.0	75.0
Asset turnover (x)	1.4	1.1	1.0	1.1	1.0	1.2
ROIC (Post-tax)	20.2	8.2	3.6	6.8	6.5	10.0
Cost of Debt (Post Tax)	3.6	2.9	3.7	3.2	3.8	3.8
Leverage (x)	0.3	0.3	0.3	0.2	0.2	0.1
Operating ROE	24.9	9.8	3.6	7.4	6.9	10.5
<b>Returns (%)</b>						
RoCE (Pre-tax)	25.3	10.9	4.1	8.7	8.6	13.3
Angel RoIC (Pre-tax)	27.7	12.0	4.5	9.5	9.1	14.1
RoE	28.2	12.2	5.9	8.2	8.0	11.5
<b>Turnover ratios (x)</b>						
Asset Turnover (Gross Block)	1.9	1.4	1.1	1.1	1.1	1.1
Inventory / Sales (days)	88	103	111	91	91	90
Receivables (days)	48	46	46	49	49	49
Payables (days)	45	43	90	61	64	63
WC cycle (ex-cash) (days)	106	113	97	81	88	82
<b>Solvency ratios (x)</b>						
Net debt to equity	0.3	0.3	0.2	0.2	0.1	0.0
Net debt to EBITDA	0.7	1.4	1.4	1.1	0.6	0.1
Int. Coverage (EBIT / Int.)	23.3	11.4	4.1	11.3	13.1	42.3

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2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

<b>Ratings (Based on expected returns over 12 months investment period):</b>	Buy (> 15%)	Accumulate (5% to 15%) Reduce (-5% to -15%)	Neutral (-5 to 5%) Sell (< -15)
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