

Indoco Remedies

Performance Highlights

Y/E March (₹ cr)	2QFY17	1QFY17	% chg (qoq)	2QFY16	% chg (yoy)
Net sales	276	253	9.4	248	11.6
Other operating income	6	5	13.7	8	(25.4)
Gross profit	179	164	9.6	160	12.4
Operating profit	37	37	0.5 bp	38	(3.0)bp
Net profit	22	20	11.8	22	2.7

Source: Company, Angel Research

Indoco Remedies posted sales of ₹276cr vs. ₹248cr in 2QFY16, up by 11.6% yoy, mainly on back of domestic sales (₹168.8cr, which grew by 22.0% yoy). Overall, the formulations, which posted sales of ₹261.4cr grew, by 13.0% yoy. The API (₹135.9cr) dipped by 11.0% yoy. On the operating front, the gross margin came in at 64.9% (65.0% expected) vs. 64.4% in 2QFY2016, with EBITDA margin coming in at 13.5% (15.5% expected) vs. 15.5% in 2QFY2016. Consequently, the PAT came in at ₹22.1cr vs. ₹21.5cr, a yoy growth of 2.7%. This was against the expectations of ₹25cr. **We recommend a reduce rating on back of expensive valuations.**

Results lower than expected: Indoco Remedies posted sales of ₹276cr vs. ₹248cr, up by 11.6% yoy, mainly on back of domestic sales (₹168.8cr, which grew by 22.0% yoy). Overall, the formulations, which posted sales of ₹261.4cr, grew by 13.0% yoy. The API (₹135.9cr) dipped by 11.0% yoy. On the operating front, the gross margin came in at 64.9% (65.0% expected) vs. 64.4% in 2QFY2016, with EBITDA margin coming in at 13.5% (15.5% expected) vs. 15.5% in 2QFY2016. Consequently, the PAT came in at ₹22.1cr vs. ₹21.5cr, a yoy growth of 2.7%. This was against, the expectations of ₹25cr.

Outlook and valuation: We expect net sales to post a CAGR of 14.9% to ₹1,289cr and EPS to post a CAGR of 33.2% to ₹16.0 over FY2016-18E. At the current market price, the stock is trading at 23.9x and 17.3x its FY2017E and FY2018E earnings, respectively. **We recommend a reduce rating on back of the valuations.**

Key financials (Consolidated)

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E
Net sales	852	977	1112	1289
% chg	18.0	14.6	13.8	16.0
Net profit	82.8	83.0	106.6	147.1
% chg	42.3	0.2	28.4	38.0
EPS (₹)	9.0	9.0	11.6	16.0
EBITDA margin (%)	18.9	14.9	16.2	18.2
P/E (x)	30.8	30.7	23.9	17.3
RoE (%)	17.0	15.1	17.0	20.1
RoCE (%)	18.3	11.9	14.4	19.1
P/BV (x)	4.9	4.4	3.8	3.2
EV/Sales (x)	3.1	2.7	2.4	2.0
EV/EBITDA (x)	16.3	18.3	14.9	11.1

Source: Company, Angel Research; Note: CMP as of November 8, 2016

REDUCE

CMP	₹277
Target Price	₹240

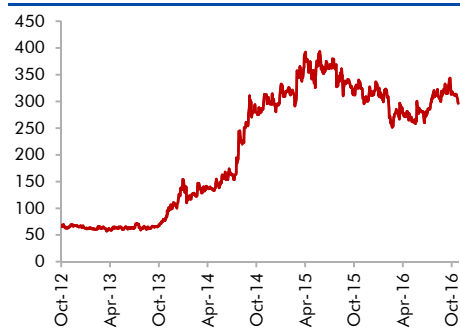
Investment Period	-
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Stock Info	
Sector	Pharmaceutical
Market Cap (₹ cr)	2,550
Net Debt (₹ cr)	113
Beta	0.5
52 Week High / Low	360/244
Avg. Daily Volume	14,497
Face Value (₹)	2
BSE Sensex	27,591
Nifty	8,544
Reuters Code	INRM.BO
Bloomberg Code	INDR@IN

Shareholding Pattern (%)	
Promoters	59.2
MF / Banks / Indian Fls	11.8
FII / NRIs / OCBs	12.6
Indian Public / Others	16.4

Abs. (%)	3m	1yr	3yr
Sensex	(2.1)	5.0	33.5
Indoco	(11.0)	(9.3)	198.2

3-Year Daily Price Chart



Source: Company, Angel Research

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Exhibit 1: 2QFY2017 (Consolidated) performance

Y/E March (₹ cr)	2QFY2017	1QFY2017	% chg (qoq)	2QFY2016	% chg (yoy)	1HFY2017	1HFY2016	% chg (yoy)
Net sales	276	253	9.4	248	11.6	529	467	13.4
Other income	5.6	5.0	13.7	8	(25.4)	11	15	(30.0)
Total income	282	258	9.4	255	10.5	540	482	12.0
Gross profit	179	164	9.6	160	12.4	343	297	15.4
Gross margin (%)	64.9	64.8		64.4		64.8	63.7	
Operating profit	37.3	37.2	0.5	38.5	(3.0)	74.5	72.7	2.4
OPM (%)	13.5	14.7		15.5		14.1	15.6	
Interest	2	2	(35.7)	3	(40.1)	4	4	(1.5)
Dep & amortisation	17	17	(0.7)	15	12.0	33	30	12.1
PBT	25	23	8.1	29	(13.4)	48	54	(11.7)
Provision for taxation	2.6	3.1	(15.9)	6	(56.3)	6	12	(50.9)
Reported Net profit	22	20	11.8	22	2.7	42	42	(1.0)
Less : Exceptional items	0	0	-	0		0	0	
PAT after exceptional items	22	20	11.8	22	2.7	42	42	(1.0)
EPS (₹)	2.4	2.1		2.3		4.5	4.6	

Source: Company, Angel Research

Exhibit 2: 2QFY2017 – Actual vs. Angel estimates

(₹ cr)	Actual	Estimate	Variation (%)
Net sales	276	274	0.8
Other operating income	6	5	12.8
Operating profit	37	43	(12.2)
Tax	3	3	(16.5)
Net profit	22	25	(11.5)

Source: Company, Angel Research

Revenues just in line with expectations: Indoco Remedies posted sales of ₹276cr vs. ₹248cr, up by 11.6% yoy, mainly on back of domestic sales (₹168.8cr, which grew by 22.0% yoy). Overall the formulations, which posted sales of ₹264cr, grew by 13.0% yoy. The API (₹135.9cr) posted a sales dip of 11.0% yoy.

The formulations (₹261.3cr) posted a yoy growth of 13.0%, while API (₹135.9cr) de-grew 11.0% yoy. Formulations growth was driven by domestic formulations (₹168.8cr), which posted a yoy growth of 22.0%, while export formulations (₹92.5cr) de-grew by 0.4% yoy.

During the quarter, the company launched 3 new products, one each in Gastro Intestinal, Pain / Analgesics and Stomatologicals, respectively.

During the quarter, the international formulation business revenues were at ₹92.5cr as against ₹ 92.9cr during the same period last year. Europe contributed to 35.8 % of International formulation sales, followed by US at 29.4 %, South Africa, Australia & New Zealand at 19.5 % and Emerging markets at 15.3 %.

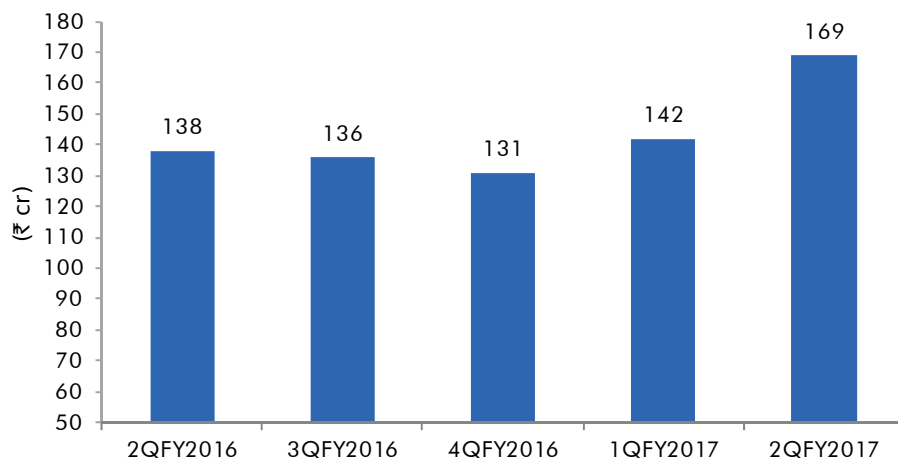
The regulated markets during the quarter de-grew by 6.3% yoy to ₹77.2cr as against ₹82.3cr, during the same quarter last year. The Emerging markets (₹15.4cr) posted a yoy growth of 46.2%.

During the quarter, the company's US business de-grew by 0.75% yoy with revenues at ₹26.2cr. The market share of ophthalmic products launched through Actavis is showing an upward trend. The company (through partners or by itself)

filed 24 ANDAs which are pending approvals; 10 ANDAs have been approved till date.

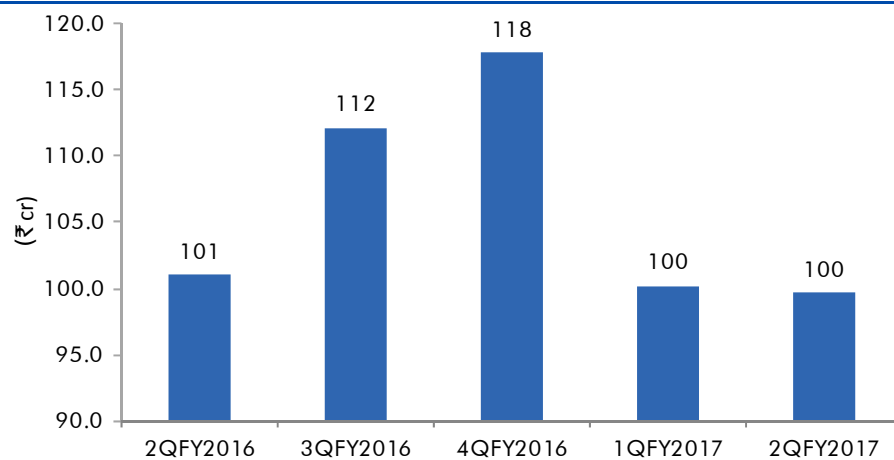
For the quarter, emerging markets grew by 46.2% to ₹15.3cr as against ₹10.3cr, during the same quarter last year. The markets which are driving growth are Kenya, French West Africa, Myanmar, Tanzania, and Sri Lanka.

Exhibit 3: Domestic Formulation sales trend



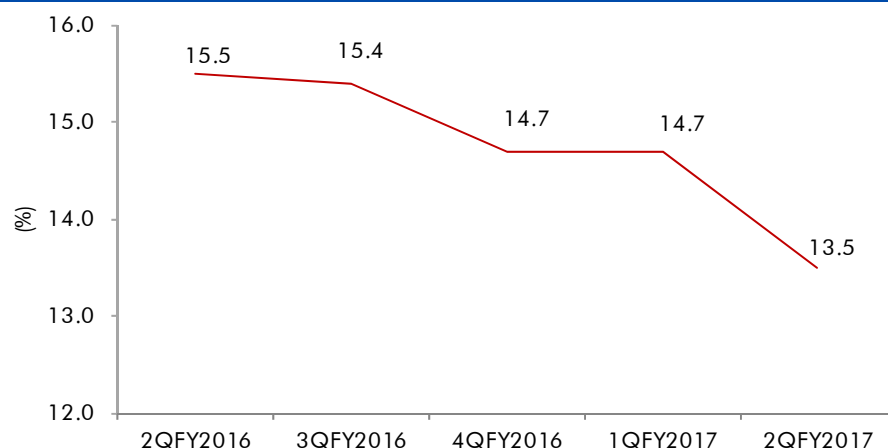
Source: Company, Angel Research

Exhibit 4: Export sales trend



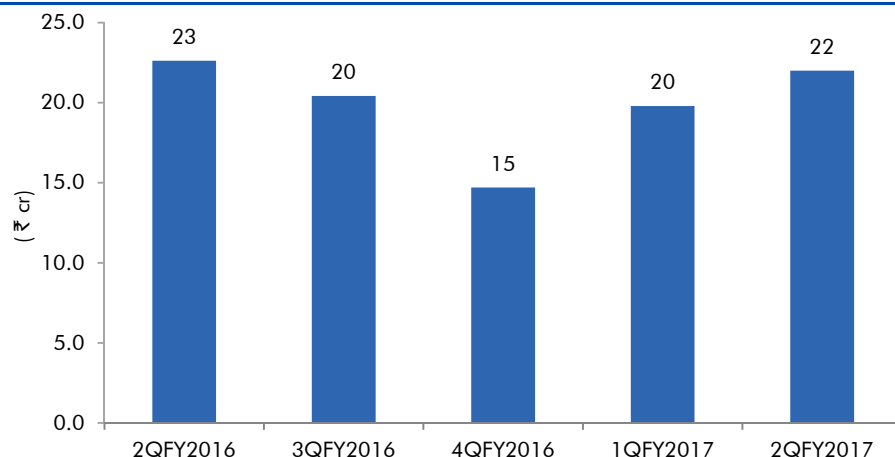
Source: Company, Angel research

OPM lower than estimated: On the operating profit front, the OPM came in at 13.5% vs. 15.5% in 2QFY2016 and vs. 15.5% expected. Dip in the OPM was mainly on back of low sales growth and 34.8% yoy rise in R&D expenses, which were around 4.4% of sales vs. 3.6% of sales in 2QFY2016.

Exhibit 5: OPM trend


Source: Company, Angel Research

Net profit lower than expectation: Company posted an Adj. net profit of ₹22cr vs. ₹23cr in 2QFY2016, a yoy de-growth of 2.2%. The net profit came below our expectation of ₹25cr.

Exhibit 6: Net profit trend


Source: Company, Angel Research

Concall Highlights

- With medical reps of 2800, management expects 15-20% sales growth in India formulations.
- USFDA audited Goa Plant II & III in September16. The inspection was triggered on account of injectable filings. The Company has submitted the compliance with documentary evidence to USFDA on all the observations covered in the inspection report.
- The company has guided for ~4% of sales of R&D in FY2017-2018.
- Indoco plans to file 8-10 ANDAs in FY2017E including 3-4 own ANDAs and 6-7 Actavis ANDAs. Till date, the company has filed 16 ANDAs (including 14 ophthalmic) out of its partnership of 25 ANDAs with Actavis and Akorn.

Investment arguments

Focus on domestic formulations- Aiming for a higher-than-industry growth: Indoco has a strong brand portfolio of 135 products and a base of ~2,800 MRs. It operates in various therapeutic segments including anti-infective, anti-diabetic, CVS, ophthalmic, dental care, pain management and respiratory. Prominent Indoco brands include *Cyclopam*, *Vepan*, *Febrex Plus*, *ATM*, *Sensodent-K* and *Sensoform*. The company has seen strong growth across the respiratory, anti-infective, ophthalmic and alimentary therapeutic segments. Further, the company is investing to enhance the share of the chronic segment, which constitutes 10% of overall sales.

Post the restructuring of the domestic business in FY2009, which has resulted in an improvement in the working capital cycle, Indoco is back on the growth trajectory with its domestic formulation business growing at 15.1% in FY2015. We expect the domestic formulation segment to grow at a CAGR of 15.0% over FY2016-18E, factoring in a muted FY2016, restructuring, and low monsoon.

Scaling-up on the exports front: Indoco has also started focusing on regulated markets by entering into long-term supply contracts. The company is currently executing several contract-manufacturing projects, and covering a number of products for its clients in the UK, Germany and Slovenia. Indoco has received a nod from the USFDA for two of its facilities in Goa. The company derived ~46% of its revenues from exports in 2015-16.

The US cumulative ANDA filings stood at 34 with 26 pending approvals (including 3 tentative approvals). 54 products are under the development pipeline for the US. The company has launched 8 products in the US market (five ophthalmic, one solid dosage and two products supplied by Watson). A total of 14 products have been filed through Watson. We expect the exports segment to grow at an 18.1% CAGR over FY2016-18E.

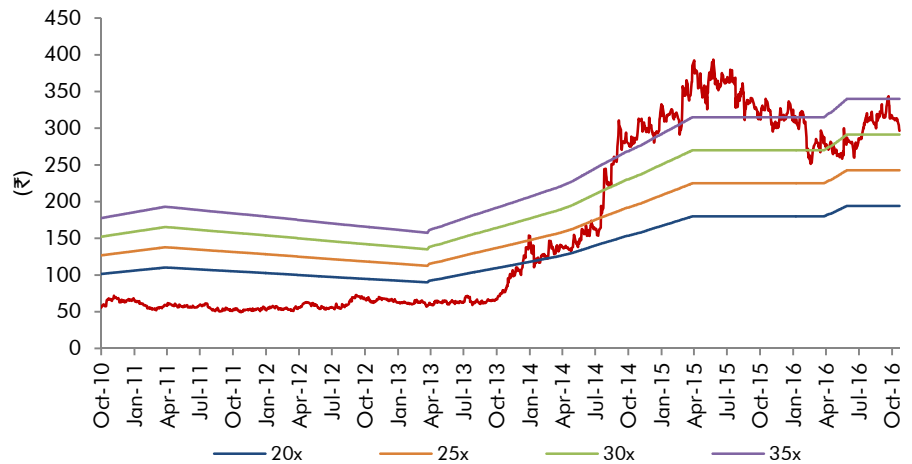
Partnering with pharmaceutical majors: The company has a large customer base of small and medium sized generic companies across the globe and has major tie-ups with generic companies for certain territories and products. The company has a deal with Watson Pharmaceuticals to develop and manufacture a number of sterile (ophthalmic) products for marketing in the USA. The agreement with South Africa's largest pharmaceutical company, Aspen Pharmacare, encompasses a number of solid dosages and ophthalmic products, extending to 30 emerging market countries, while the contract signed with DSM, Austria is for marketing 8 of Indoco's APIs in various geographies. These deals have further strengthened Indoco's image in the international arena.

Valuation: We expect net sales to post a CAGR of 14.9% to ₹1,289cr and EPS to post a CAGR of 33.2% to ₹16.0 over FY2016-18E. At the current market price, the stock is trading at 23.9x and 17.3x its FY2017E and FY2018E earnings, respectively. **We recommend a reduce rating on back of the valuations.**

Exhibit 7: Key assumptions

	FY2017E	FY2018E
Domestic sales growth (%)	15.0	15.0
Exports growth	18.0	18.0
Operating margins (%)	18.2	18.2
Capex (₹ cr)	60.0	60.0

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	FY2018E			FY16-18E	FY2018E	
		(₹)	(₹)	(%)	PE (x)	EV/Sales (x)	EV/EBITDA (x)	CAGR in EPS (%)	RoCE (%)	RoE (%)
Alembic Pharma	Neutral	655	-	-	21.6	2.9	13.5	(10.8)	27.5	25.3
Aurobindo Pharma	Buy	757	877	15.9	16.0	2.6	11.1	18.1	22.5	26.1
Cadila Healthcare	Buy	375	-	-	19.5	3.0	13.7	13.4	22.7	25.7
Cipla	Neutral	536	-	-	19.7	2.5	13.6	20.4	13.5	15.2
Dr Reddy's	Neutral	3,115	-	-	21.8	2.8	12.5	1.7	16.2	15.9
Dishman Pharma	Neutral	237	-	-	21.0	2.3	10.3	3.1	10.3	10.9
GSK Pharma*	Neutral	2,719	-	-	44.7	6.8	32.8	17.3	35.3	32.1
Indoco Remedies	Reduce	277	240	(13.4)	17.3	2.0	11.1	33.2	19.1	20.1
Ipca labs	Accumulate	572	613	7.2	29.0	2.0	13.1	36.5	8.8	9.4
Lupin	Buy	1,509	1,809	19.9	21.8	3.6	13.4	17.2	24.4	20.9
Sanofi India*	Neutral	4,277	-	-	24.9	3.3	17.8	22.2	24.9	28.8
Sun Pharma	Buy	635	944	48.6	19.4	3.8	12.2	22.0	33.1	18.9

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

Company Background

Indoco has a strong brand portfolio of 135 products and a base of 2,300 MRs. The company operates in various therapeutic segments including anti-infective, anti-diabetic, CVS, ophthalmic, dental care, pain management and respiratory areas. Prominent Indoco brands include Cyclopam, Vepan, Febrex Plus, ATM, Sensodent-K and Sensoform. The company's top-10 brands contribute over 50% of its domestic sales. Indoco now proposes to scale up its exports through higher exposure to the regulated markets.

Profit & loss statement (Consolidated)

Y/E March (₹ cr)	FY13	FY14	FY15	FY16	FY17E	FY18E
Gross sales	638	735	863	987	1,124	1,303
Less: Excise duty	11	13	11	10	12	14
Net sales	626	722	852	977	1,112	1,289
Other operating income	4	10	5	27	27	27
Total operating income	630	733	857	1,004	1,139	1,316
% chg	10.4	16.2	17.0	17.1	13.5	15.6
Total expenditure	537	612	691	831	932	1,055
Net raw materials	262	272	300	341	434	477
Other mfg costs	37	42	50	57	65	75
Personnel	100	130	140	183	199	231
Other	138	168	201	250	234	272
EBITDA	89	110	161	145	180	234
% chg	5.4	23.5	46.1	(9.7)	23.7	30.3
(% of Net Sales)	14.2	15.2	18.9	14.9	16.2	18.2
Depreciation & amortisation	24	31	47	60	65	70
EBIT	65	79	114	85	114	164
% chg	0.1	21.0	43.7	(25.4)	34.7	43.3
(% of Net Sales)	10.4	11.0	13.3	8.7	10.3	12.7
Interest & other charges	22	19	11	13	13	13
Other income	1	2	2	1	1	1
(% of PBT)	1.8	2.4	1.6	1.1	0.9	0.6
Share in profit of Associates	-	-	-	1.0	2.0	3.0
Recurring PBT	48	72	110	101	130	179
PBT (reported)	48	72	110	101	130	179
Tax	6	14	27	18	23	32
(% of PBT)	11.8	19.6	24.3	17.5	18.0	18.0
PAT (reported)	43	58	83	83	107	147
Add: Share of earnings of asso.	-	-	-	-	-	-
Less: Minority interest (MI)	-	-	-	-	-	-
Prior period items	-	-	-	-	-	-
PAT after MI (reported)	43	58	83	83	107	147
ADJ. PAT	43	58	83	83	107	147
% chg	(7.9)	36.5	42.3	0.2	28.4	38.0
(% of Net Sales)	6.8	8.1	9.7	8.5	9.6	11.4
Basic EPS (₹)	4.6	6.3	9.0	9.0	11.6	16.0
Fully Diluted EPS (₹)	4.6	6.3	9.0	9.0	11.6	16.0
% chg	(7.9)	36.5	42.3	0.2	28.4	38.0

Balance Sheet (Consolidated)

Y/E March (₹ cr)	FY13	FY14	FY15	FY16	FY17E	FY18E
SOURCES OF FUNDS						
Equity share capital	18	18	18	18	18	18
Reserves & surplus	396	439	500	566	652	778
Shareholders funds	414	457	519	583	669	796
Minority Interest	0	-	-	-	-	-
Total loans	90	72	88	127	130	70
Other Long Term Liab.	9	9	9	9	9	9
Long Term Provisions	7	16	16	18	18	18
Deferred tax liability	35	31	27	24	24	24
Total liabilities	555	585	659	762	824	890
APPLICATION OF FUNDS						
Gross block	447	481	561	649	709	769
Less: acc. depreciation	126	156	203	264	329	399
Net block	321	325	358	386	380	370
Capital work-in-progress	38	44	44	44	44	44
Goodwill	0	-	0	-	-	-
Investments	0	0	0	15	15	15
Long Term Loans And Adv.	57	55	58	71	109	126
Current assets	273	305	385	448	549	653
Cash	12	13	15	14	8	25
Loans & advances	41	42	85	78	111	129
Other	220	249	285	356	430	499
Current liabilities	134	144	187	201	274	318
Net current assets	139	160	199	247	275	335
Mis. Exp. not written off	0	-	-	-	-	-
Total assets	555	585	659	762	824	890

Cash Flow Statement (Consolidated)

Y/E March (₹ cr)	FY13	FY14	FY15	FY16	FY17E	FY18E
Profit before tax	48	72	110	101	130	179
Depreciation	24	31	47	60	65	70
(Inc)/Dec in working capital	13	(18)	(39)	(63)	(73)	(60)
Less: Other income	1	2	2	1	1	1
Direct taxes paid	6	14	27	18	23	32
Cash Flow from Operations	79	69	90	80	98	156
(Inc.)/Dec.in fixed assets	(49)	(41)	(80)	(88)	(60)	(60)
(Inc.)/Dec. in investments	-	-	-	-	-	-
Other income	1	2	2	1	1	1
Cash Flow from Investing	(48)	(39)	(78)	(87)	(59)	(59)
Issue of equity	-	-	-	(1)	-	-
Inc./(Dec.) in loans	(22)	(9)	16	41	3	(60)
Dividend Paid (Incl. Tax)	(12)	(12)	(22)	(21)	(21)	(21)
Others	3	(16)	(3)	(15)	9	-
Cash Flow from Financing	(30)	(37)	(9)	5	(9)	(81)
Inc./(Dec.) in Cash	1	(7)	3	(2)	30	17
Opening Cash balances	10	12	13	15	14	8
Closing Cash balances	12	13	15	14	8	25

Key Ratios

Y/E March	FY13	FY14	FY15	FY16	FY17E	FY18E
Valuation Ratio (x)						
P/E (on FDEPS)	59.8	43.8	30.8	30.7	23.9	17.3
P/CEPS	38.4	28.6	19.6	17.8	14.8	11.7
P/BV	6.2	5.6	4.9	4.4	3.8	3.2
Dividend yield (%)	0.4	0.4	0.7	0.7	0.7	0.7
EV/Sales	4.2	3.6	3.1	2.7	2.4	2.0
EV/EBITDA	29.5	23.7	16.3	18.3	14.9	11.1
EV / Total Assets	4.7	4.5	4.0	3.5	3.2	2.9
Per Share Data (₹)						
EPS (Basic)	4.6	6.3	9.0	9.0	11.6	16.0
EPS (fully diluted)	4.6	6.3	9.0	9.0	11.6	16.0
Cash EPS	7.2	9.7	14.1	15.6	18.7	23.6
DPS	1.1	1.0	2.0	2.0	2.0	2.0
Book Value	44.9	49.6	56.3	63.3	72.6	86.4
DuPont Analysis						
EBIT margin	10.4	11.0	13.3	8.7	10.3	12.7
Tax retention ratio	88.2	80.4	75.7	82.5	82.0	82.0
Asset turnover (x)	1.2	1.3	1.4	1.4	1.5	1.6
ROIC (Post-tax)	10.8	11.6	14.2	10.3	12.3	16.3
Cost of Debt (Post Tax)	18.9	18.7	10.0	9.6	8.0	10.3
Leverage (x)	0.2	0.2	0.1	0.2	0.2	0.1
Operating ROE	8.9	10.4	14.8	10.5	13.1	17.0
Returns (%)						
ROCE (Pre-tax)	11.9	13.9	18.3	11.9	14.4	19.1
Angel ROIC (Pre-tax)	13.0	15.3	20.2	13.0	15.5	20.5
ROE	10.7	13.4	17.0	15.1	17.0	20.1
Turnover ratios (x)						
Asset Turnover (Gross Block)	1.5	1.6	1.6	1.7	1.7	1.8
Inventory / Sales (days)	52	50	55	54	58	60
Receivables (days)	66	64	62	68	74	76
Payables (days)	43	40	46	42	50	52
WC cycle (ex-cash) (days)	78	68	70	76	80	80
Solvency ratios (x)						
Net debt to equity	0.2	0.1	0.1	0.2	0.2	0.1
Net debt to EBITDA	0.9	0.5	0.5	0.8	0.7	0.2
Interest Coverage (EBIT / Int.)	3.0	4.2	10.7	6.8	9.1	13.1

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1. Financial interest of research analyst or Angel or his Associate or his relative	No
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

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)