

Indoco Remedies - 2QFY11 results review - Strong operational performance

BUY

CMP: INR471

Target Price : INR594

Potential Upside: 20%

Indoco's total operational income increased by 41% to INR1.3bn in 2QFY11 on account of higher other operational income (up from INR6m in 2QFY10 to INR31m in 2QFY11). The company reported a considerable growth of 39% to INR1.3bn underpinned by strong growth in domestic and international markets.

Segmental analysis

Domestic business (including API) witnessed a strong growth of 38.6% to INR920m. On account of a robust growth in respiratory and anti-infective segment, domestic formulations segment registered a growth of 37.2% during the quarter. This was largely driven by new product introductions such as Flamar-P, V-Cef-O, Osteoflam Injections in the new SBU Xtend. Furthermore, new products launched in the domestic formulations segment during the second quarter are: Osteochek, Gemsharp, Zolorab/D, Pgb-12, Deflachek, LorcheK P, LorcheK MR.

Despite lower exchange rate realisation during 2QFY11, international formulation exports witnessed a 35.4% growth in sales at INR352.7m. Indoco's Levocetirizine Tablets are getting a nod from the Hungarian regulatory authority. This provides an opportunity to introduce products under the MRP (Mutual Recognition Procedures) in various countries in the EU region and monetise the same in the near future. The company also filed new product applications in Australia, UK and some other regions in the EU through its marketing partners. Indoco's Paracetamol Tablets got registered in Denmark and we expect commercial supplies of the same to begin 3QFY11 onwards.

Segmental analysis

INRm	2QFY11	2QFY10	Chg (%)	1HFY11	1HFY10	Chg (%)	1QFY11	Chg (%)
Domestic								
Formulations	884.4	644.8	37.2	1,610.1	1,322.9	21.7	725.8	21.9
API	35.6	19.2	85.4	65.2	43.0	51.6	29.6	20.3
Total domestic	920.0	664.0	38.6	1,675.3	1,365.9	22.7	755.4	21.8
Formulation exports								
Regulatory	271.2	226.5	19.7	521.5	451.1	15.6	250.3	8.3
Semi-regulatory	81.5	33.9	140.4	159.5	78.8	102.4	78.0	4.5
Total formulation exports	352.7	260.4	35.4	681.0	529.9	28.5	328.3	7.4
API exports	50.7	29.9	69.6	80.9	41.9	93.1	30.1	68.4
Gross total sales	1,323.4	954.3	38.7	2,437.2	1,937.7	25.8	1,113.8	18.8

Source: Company, Antique

Supply arrangement update

Indoco-Watson JV: The relationship of this joint venture has been strengthened with Watson expanding the product development and supply pipeline by four additional products. These new products have a market size of USD765m.

Indoco-Aspen JV: The relationship of this joint venture has been expanded with the addition of a number of products in the liquid orals, tablets and creams to cater to Aspen's requirement in the LatAM and Sub-Saharan Africa including South Africa.

The expansion of overall scope of the deal is expected to provide credibility to Indoco's operations and its delivery capabilities to enhance the Contract Research and Manufacturing Services (CRAMS) business.

Other highlights

Emerging markets witnessed a strong growth of 140% at INR81.5m in 2QFY11, led by increased traction in the African and LatAM markets. Company's entry into Namibia and Botswana is expected to consolidate its presence in African markets further. With facilities receiving approvals from various regulatory authorities, we expect Indoco to start filing more product registrations during the year.

The emerging market division introduced 11 products during the quarter providing an opportunity to commercialise them in 3QFY11.

Operating profits increased largely on account of higher revenues. However, operating profits could have been much higher but were impacted due to increase in material cost and lower realisation in exports aided by currency headwinds.

Business growth in foreign currency terms witnessed a strong improvement of 48% during 2QFY11. Company incurred higher employee costs aided by employee addition in the new divisions of ETERNA and XTEND (created in 1QFY11). Operating margins expanded by 200bps to 15.6% YoY, however, declined marginally by 150bps QoQ.

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Efficient working capital cycle and lower interest costs boost profitability

The overall working capital cycle has decreased to 78 days in 2QFY11 from 82 days in 4QFY10 aided by better credit control measures by the company.

Interest costs squeezed by 20% at INR5.3m on account of increasing loans taken in foreign currency denominations. This has helped net profit to grow by a considerable 65% at INR152.6m during the quarter.

Valuation and recommendation

The rising confidence of execution capabilities coupled with deals of Watson and Aspen in the CRAMs segment and robust domestic market growth places Indoco on a very strong growth trajectory.

At the CMP of INR471, the stock trades at a PER and EV/EBIDTA of 6.4x and 4.2x discounting its FY12e earnings of INR74.3. We reiterate a BUY rating on the stock with a target price of INR594.

Quarterly financials

INRm	2QFY11	2QFY10	Chg (%)	1HFY11	1HFY10	Chg (%)	1QFY11	Chg (%)
Net sales	1,323	954	39	2,437	1,938	26	1,114	19
Other oper. income	31	6	384	46	29	57	15	108
Total oper. income (TOI)	1,354	961	41	2,483	1,967	26	1,129	20
Net Raw Mat adj.	605	407	49	1,092	810	35	487	24
% to Tol	44.7	42.4		44.0	41.2		43.1	
Other expenses	333	255	30	618	495	25	285	17
% to Tol	24.6	26.6		24.9	25.2		25.2	
R&D Exp	22	22		41	47		19	
% to Tol	1.6	2.3		1.7	2.4		1.7	
Personnel	185	145	28	333	274	22	148	26
% to Tol	13.7	15.1		13.4	13.9		13.1	
Total expenditure	1,146	830	38	2,084	1,627	28	938	22
Operating profit	208	131	59	399	340	17	191	9
OPM (%)	15.4	13.6		16.1	17.3		16.9	
Non-operating income	0.1	0.6		0.1	1.4		0.0	
Interest	5.3	6.6	(20)	11.8	15.9	(26)	6.5	(18)
Gross profit	203	125	63	387	325	19	184	10
GPM (%)	15.0	13.0		15.6	16.5		16.3	
Depreciation	33.5	28.9	16	65.6	56.8	15	32.1	4
PBT before extra-ord	170	96	77	322	269	20	152	12
PBT (%)	12.5	10.0		13.0	13.7		13.5	
Tax expense	13.0	0.0		13.0	0.0		0.0	
Tax/PBT (%)	10.0	3.5		6.5	2.8		2.6	
Profit after Cur. Tax	157	96	63	309	269	15	152	3
Deferred Tax	4.0	3.4	18	7.9	7.4	7	3.9	
Profit after Tax	153	92	65	301	261	15	148	3
PAT (%)	11.3	9.6		12.1	13.3		13.1	
Equity share capital	123	123	0	123	123	0	123	0
EPS (INR)	12.4	7.5	65	24.5	21.3	15	12.1	3
CEPS (INR)	15.5	10.2	52	30.5	26.5	15	15.0	3

Source: Company, Antique