

October 12, 2010

India Equity Research | **Research Report** | Pharmaceuticals

INDOCO REMEDIES LIMITED (INDR IN)

"Domestic business and tender-partnership model to lead growth"

CMP ₹448

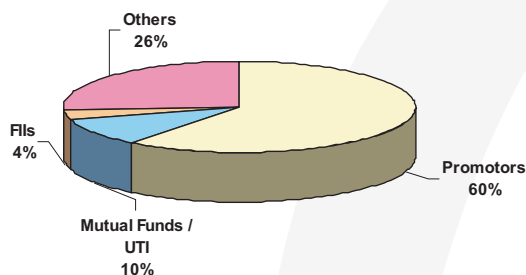
Target Price ₹578

BUY

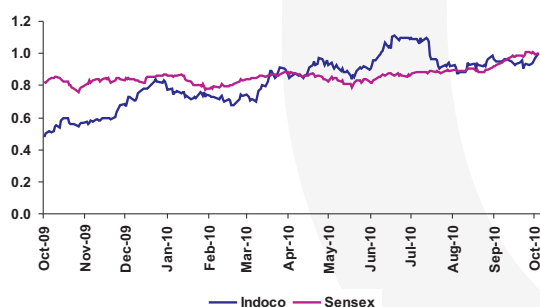
COMPANY SNAPSHOT (October 11, 2010)

Market Price	Sensex
₹448	20340
52 Wk H / L	Bloomberg Code
₹523 / 225	INDR IN
Mkt Cap (mn)	Shares O/S (mn)
₹5500	12
BSE CODE	NSE CODE
532612	INDOCO
Equity (Mn)	Face Value
123	10

Shareholding Pattern



Price Performance Chart



Quick Fundamentals

Fiscal Year	Pharmaceuticals			
	FY09	FY10	FY11E	FY12E
Sales(Net) ₹Mn	3506	3983	4759	5705
EPS	26	34	42	44
OPM (%)	14.1%	14.4%	15.2%	16.4%
P/E Ratio	17.5	13.1	10.7	10.1
Price/Sales (%)	0.13	0.11	0.09	0.08
Price/Book Value	2.0	1.8	1.6	1.4
EV/EBITDA	11.5	10.0	8.0	6.0
Dividend per share	2.0	7.0	7.0	7.0
EBITDA/Sales	0.1	0.1	0.2	0.2

Indoco Remedies, initially known as **Indo Continental** Trading Company, formed in the year 1947, is engaged in the manufacturing and marketing of Formulations (Finished dosage forms) and APIs (Active Pharmaceutical Ingredients). It is among the fastest growing pharma companies and currently ranks 22nd as per ORG MAT-Aug, 2010. The Company has a well-built brand portfolio of ~200 products in various therapeutic segments, including different high margin life style segments such as Cardiovascular, Anti-Diabetics, Central Nervous System, Musculo-Skeletal, Nutrition and Dental care to mention a few.

INVESTMENT RATIONALE

✓ **Expansions undertaken to cater to demand:**

In order to cater to the increasing demand and opportunities, Indoco is undertaking various expansions across its different business segments. It is setting up a new plant in Goa (Plant II) through which it would double its tablet manufacturing capacity. The trials, production and validation activities are expected to commence by Jan, 2011. The expansion of the ophthalmic sterile facility has been completed. The validation activities are in progress with the batch manufacturing expected to start soon. Besides this, Indoco has also acquired a plot in Aurangabad which would have a unit to serve the emerging markets. The Company is also planning modernization of its existing facilities at Baddi and Waluj facility after the API facility at Patalganga is done. Part of the capex would also be spent towards its R&D facilities. All of these expansions should help it enhance its capacities to meet the increasing demand.

✓ **Strong business model gives an edge in the domestic markets:**

The Company is strongly placed in the domestic market having varied marketing divisions catering to different population of doctors, with almost 70% of the revenues coming from the same. The remaining is through the exports of which 80% is from the regulated markets with major share from the UK and Germany markets. Through the export formulation segment, Indoco does contract manufacturing, supplies different molecules and sells dossiers. It has tie-ups for certain ANDA's and has started filing its own ANDA's as well. Thereby, the company is well strategized be it for the domestic market or the export front.

✓ **Inorganic complements the organic growth:**

Besides the organic growth triggers that are intact, to deal with the payment related issues in the semi-regulated markets, Indoco is exploring the tender business model structure and is entering into partnerships for further penetration into these markets. It has entered into new dossier licensing and supply deals with Watson Inc. and Aspen Pharmacare in Q4FY10. It entered into an alliance for generic product development with WATSON for seven sterile products in Feb, 2010. The deal includes ophthalmic and a few patented products also, the filings for which have already begun and approvals are expected from FY13E. With Aspen, it has entered into a dossier licensing and supply deal for supply of 7 ophthalmic products to 30 emerging countries which is expected to start from FY12E. Both these deals are the key growth drivers for Indoco post FY12E once all the approvals and other regulatory issues are in place.

Key Risks:

- ✓ Impact due to exchange fluctuations and Price control
 - ✓ Delay in execution of contracts
 - ✓ Sustainability of the partnership model
- All these could affect the future prospects of the company.

Recommendation

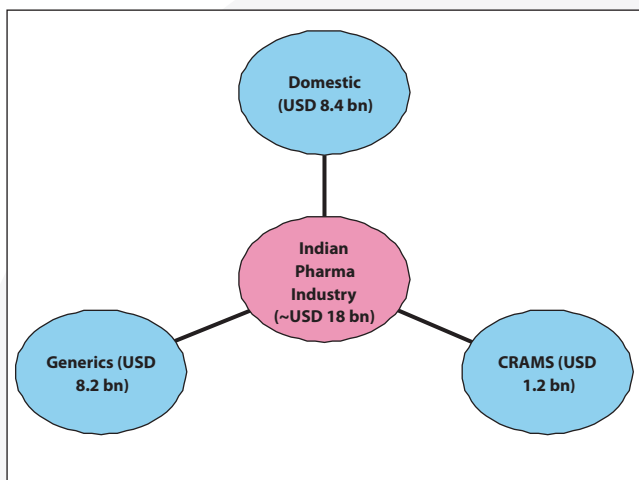
With a positive outlook on the company owing to the major deals signed with MNCs, we recommend '**BUY**' on the stock with target price of ₹578 (29% upside) at which stock would trade at 2x FY11E book value of ₹286. The stock is currently trading at 11x FY11E EPS of ₹42 and 10x FY12E EPS of ₹44.

INDUSTRY- Triggers of the Pharmaceutical Industry:

The Indian pharmaceutical industry ranks third in volume terms globally (valued at approximately USD18 bn which is 10% of the global pharma output) and 14th in terms of value. The exports for 2009 grew by around 14% compared to 2008 at USD8.6 bn. The contribution from formulation segment was 65% and that from intermediates and Active Pharmaceutical Ingredients (APIs) was around 35%. (Source: Industry)

The Indian pharma industry is expected to grow between 12-14% over next few years backed by triggers of increase in lifestyle-related chronic diseases, better medical facilities and increasing awareness and per capita income improvements. Similar trends seen in the emerging markets is providing impetus to Indian pharma companies and help maintain the growth momentum. (Source: Industry)

Chart 1: Major Constituents of the Indian Pharmaceutical Sector



Source: Industry

Indian Players to benefit from the growth potential in Emerging Markets:

The Emerging markets are better placed with the positives of lower costs and greater market opportunity when compared to the higher risks associated with the established economies. In the past the developed economies like US and EU were the key focus markets, however there is a gradual trend reversal towards the emerging markets which would be higher contributors of growth in the future as per industry experts.

The focus on the emerging markets by most of the generic companies is rapidly increasing due to better growth expected as compared to the developed economies. On similar lines the Indian pharma companies are also better placed compared to their global peers in attracting generic opportunities betting on the low cost advantage and better hold in terms of selling branded generics in India.

Opportunity through the innovators:

On comparison with the global innovator pharma companies that are trading at the lower-end of their ten year PE band, Indian Companies are enjoying an edge. The Global Pharmaceutical players are facing issues like different patent expiries that are lined up over the next few years and drying of the product pipeline with not many blockbusters to offer. The situation is further intensified due to the stringent regulatory framework getting tougher for better compliance and vigilance handling. This automatically benefits the emerging markets, with the Indian players taking the lead in grabbing from the diversion of business. The efforts of the innovator pharmaceutical companies to change their business models by increasing exposure to emerging markets and changing their focus towards budding sectors would take time to fructify and start benefitting, which paves the way for Indian Pharma players to grab the available growth opportunities.

Opportunities in the Domestic Market: India

With the perspective of maintaining growth and compensating for the patent losses along with sorting ways to reduce costs, most of the MNCs have resorted to outsourcing (Generic market) as a solution. India is well positioned with its manufacturing expertise and added advantage of low cost skilled talent pool all of these well equipped to meet the required quality standards. There have also been huge investments undertaken by pharma companies in order to ramp up their capacities and grab the maximum of the generic opportunities which has gradually started surfacing.

Generics- A Visible Opportunity:

One of the key focuses of the pharma companies is the huge generic opportunity underway. With about USD 140 bn drugs going off-patent over the next 5 years, the Indian players would benefit due to the edge provided with the regulatory approvals in place and so also the required manufacturing facilities. Thereby, the Generics market remains a key trigger for the growth of the Indian Pharma companies.

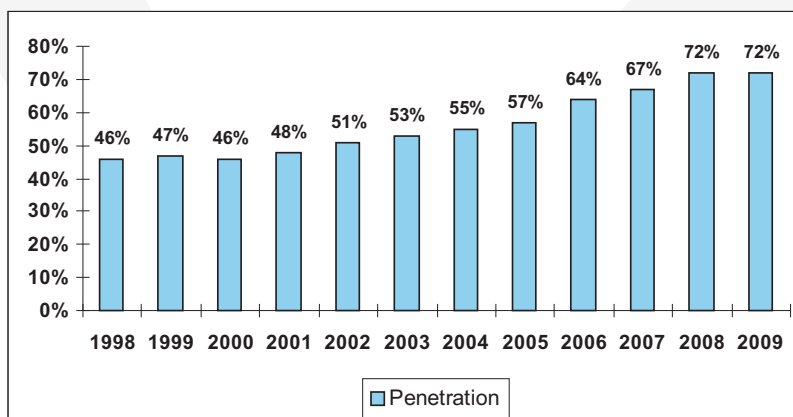
Chart 2: Some of the key drugs going off patent:

Drug	Year	Opportunity (USD bn)	Innovator Co.
Aricept	2010	3	Eisai. Co
Taxotere	2010	3	Sanofi-Aventis
Cozaar	2010	4	Merck & Co Inc
Zyprexa	2011	5	Eli Lilly & Co
Plavix	2011	6	Bristol-Myers Squibb Co
Lipitor	2011	12	Pfizer
Seroquel	2012	4	Astra Zeneca PLC
Singulair	2012	4	Merck & Co Inc
Diovan	2012	6	Novartis AG
Cymbalta	2013	3	Eli Lilly & Co
MabThera	2013	5	Roche Holding AG
Celebrex	2014	2	Pfizer
Nexium	2014	5	Astra Zeneca PLC
Glivec	2015	4	Novartis AG
Herceptin	2015	5	Roche Holding AG

Source: Industry

There are a large number of products that are going off-patent over the next 3-5 years. The generic penetration in the US markets has increased from 46% in 1998 to 72% in 2009.

Chart 3: Penetration of Generic Drugs in the US:



Source: Industry

When compared to the other markets in terms of the generic penetration, US and UK markets are at the forefront then followed by the other players like Germany, Netherlands, Japan and France to mention a few.

CRAMS (Contract Research and Manufacturing Services):

The Global CRAMS market is expected to grow at a CAGR of 13% to USD73 bn over CY07-CY11E. Of this the CRO (Contract Research organization) market is expected to grow at a CAGR of 16% and the CMO (Contract Manufacturing Organization) at a CAGR of 11%. compared to the Indian CRAMS business where the penetration is just about 2.7% of the global outsourcing. India is emerging as a preferred destination for pharmaceutical companies-outsourcing of manufacturing, drug discovery, and clinical research. Asia is the preferred outsourcing destinations for global pharmaceutical companies as it provides significant cost advantage, maintaining the requisite quality standards. (Source: Industry)

Formulations:

Sales of domestic formulations have risen by around 14% annually over the past three years and are forecasted to rise by around 12-14% every year over the next three years, driven by growth in different therapeutic segments like cardiac, anti-diabetic and Neuro/CNS.

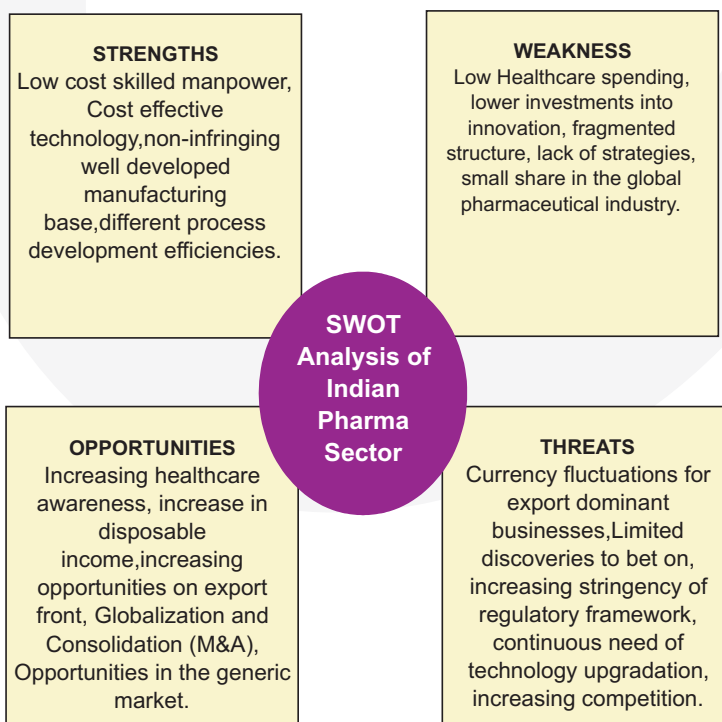
The chronic-care segment constitutes 30% of the total domestic market in terms of sales and has been expanding by an average of 17-18% annually over the past three years.(Source: Industry). In most of the developing countries including India, the acute segment has been the largest contributor. However, there is a slow transition from this low margin segment to the high margin better yielding segment of Chronic therapeutics.

Illustration of one of the opportunities:

As mentioned earlier about the shift towards chronic diseases increasing gradually, the innovator R&D budget in India is also focused on lifestyle diseases and genetic disorders, thereby not many of them getting into the production of anti-infectives over the next few years. This represents an opportunity for the domestic players .This is just an example. On similar lines there are other therapeutics as well that are under the radar of the domestic players. They are strongly working towards capitalizing on the visible prospects offered by the formulations space.

Going forward, along-with growth in existing products, introduction of new products across different therapeutic segments and various expansions being undertaken would provide a further impetus to the overall growth of the domestic formulations market in the long term.

Chart 4: SWOT Analysis of the Indian Pharmaceutical Sector:



Source:Industry

All the earlier mentioned triggers indicate the growth potential and the investment opportunities in the Pharmaceutical space across the different segments. Based on this, we have narrowed down to one of the companies that would be a beneficiary of the opportunities in the Formulations space, Generics and CRAMS namely **INDOCOREMEDIES LTD.**

About the Company:

Indoco Remedies Ltd (Indoco) is engaged in the manufacturing and marketing of Formulations (Finished Dosage Forms) and Active Pharmaceutical Ingredients (APIs) in India. It has a strong international presence in the Regulated and Emerging markets. The Company is looking at various opportunities in untapped markets and association with business partners in the global markets to boost its revenues. Indoco has a well-built brand portfolio of ~200 products in various therapeutic segments, including different high margin life style segments such as Cardiovascular, Anti-Diabetics, Central Nervous System, Musculo-Skeletal, Nutrition and Dental care to mention a few.

Chart 5: Existing Manufacturing Facilities:

Site	Dosage Form	Approvals
Goa I	Tablets Creams and Ointments	UKMHRA, German Brazil ANVISA, MCC, SA, TGA UKMHRA
Goa II	Sterile Eyedrops	USFDA, MCC, SA
Goa III	Tablets Capsules	UKMHRA, German Brazil ANVISA, MCC, SA, TGA
Waluj	Tablets	ROW
Baddi	Tablets & Liquid Orals Creams and Ointments Toothpastes	UKMHRA, GMP approval from JAZMP, agency for medical products and medical devices of the Republic of Slovenia
Patalganga	API	cGMP, geared for USFDA and EDQM inspections
Rabale	API	
Rabale	R&D	Single Window for Global Dossiers

Source: Company, GEPL Research

Facilities under development:

Besides the above mentioned facilities, to cater to the increasing demand and opportunities, the company has various other expansions being undertaken.

Goa Expansion: The Company is setting up a new plant in Goa (Plant II) with the allocation of ₹480 mn. Through this expansion the company would double its tablet manufacturing capacity to 10 bn per annum. The trials, production and validation activities are expected to commence by January, 2011.

Ophthalmic facility: Indoco has completed the expansion of the ophthalmic sterile facility. The validation activities are in progress and the company is expecting to start manufacturing the exhibit batches in the current quarter.

Expansions at Aurangabad: The Company has also acquired a plot in Aurangabad which would have a unit to serve the emerging markets. The existing storage of the company will be shifted to the new premises purchased. At the vacant space, Indoco intends to put up a tablet manufacturing plant and construct a well equipped laboratory and QC facility at the plant. The capitalization of this activity would be done by March 2011.

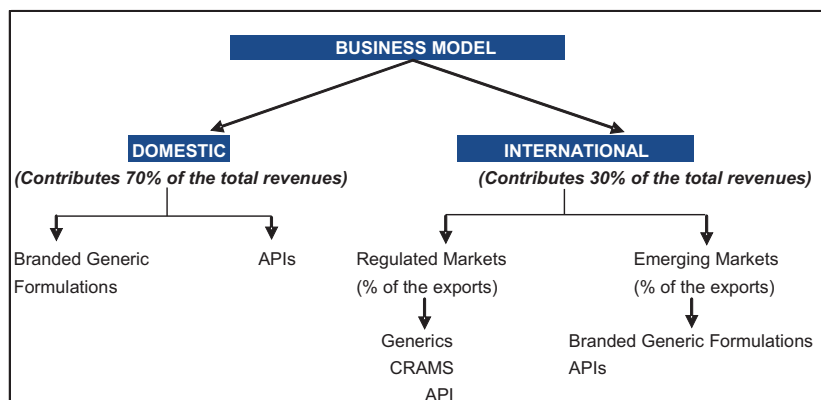
Modernization activities: The Company is also undertaking modernization of its existing facilities at Baddi and Waluj facility after the API facility at Patalganga is done. Part of the capex would also be spent towards its R&D facilities.

All of these expansions being undertaken by the company should help it enhance its capacities to meet the increasing demand.

Business Profile of the Company:

The major business segments of the company include Formulations, API and R&D. About 70% of the revenues come from the domestic markets & remaining through exports. 95% of the revenues are derived from the Formulations space and the balance by the API. 80% of the total exports is contributed by the regulated markets dominated by UK and Germany while the remaining from the emerging markets.

Chart 6: Business Model and Geographical distribution:



Source: GEPL Research

Domestic formulations business: contributes 65% to the revenues:

Indoco currently markets 200 products (incl. line extensions) focusing mainly on Anti-infectives, Respiratory & Dental that comprise of ~56% of the total domestic formulation revenues.

Description of the divisions:

There are 7 major marketing divisions including the two new divisions introduced, through which the company focuses on different therapeutic segments. It has a product basket of branded generics and value added generics across these divisions.

Indoco:

It is one of the largest & oldest divisions with a contribution of ~48% to the revenues catering to segments like anti-infectives, GI, respiratory and dermatologicals. The top products include Cyclopham, Vepan, Oxipod, Cloben-G and Karvol plus.

Spade:

This division caters to the therapeutic segments of Anti-cold, Anti-infectives, Haematinics and Calcium supplementation. The top products include Febrex Plus, ATM, Aloha XT and Methycal which are also the potential products in terms of future growth.

Warren:

This division is formed from the acquired company Warren Pharma Ltd in 1999. It is at the numero uno position in the dental care category. The other therapeutics includes stomatological, anti-infectives and analgesics. In terms of the products, the top performers are Sensodent K, Sensiform, Sensodent KF & Lignox 2%.

Spera:

This division has been formed by transferring some of the potential products from the Indoco division. Some of these products include Cital, Carmicide that are growing at around 30%.

Excel:

This niche segment caters to the needs of Ophthalmologists and ENT specialists. The growth of this segment is attributed to the products like Homide, Dexoren-S, Renolen etc.

Two newly launched divisions:

✓ **Xtend:** This division is launched to strengthen & increase the presence in the extra-urban towns for the key therapeutics like anti-infectives, pain management, anti-peptic ulcerants, appetite enhancers and lipid management.

✓ Eterna:

With the intention of building up on the growing doctor specialities such as the CPs, Orthopaedicians, Gastro-enterologists and top GPs, Eterna is started catering to anti-infectives, gastro-intestinals, pain management to mention a few.

Thus, with the different divisions mentioned above, Indoco has established brands that have a leadership position in their respective therapeutic segments.

International Strength:

Exports: Formulations segment:

This segment contributes around 29% of the total formulations sales of the company. Through this business segment, Indoco does contract manufacturing and supplies different molecules. It sells dossiers and has tie-ups for certain ANDA's. Added to this it has started filing its own ANDA's as well. Also deals with the MNCs (Watson and Aspen) that Indoco has recently entered, should help add to the contribution from this division. These would gradually have substantial inputs to the business.

Major contributor for formulations: Regulated markets:

Around 83% of the Export Formulations business is through the regulated markets catering to countries like US, UK, Germany, Eastern Europe, South Africa, Australia and New Zealand of which UK and Germany are at the forefront. The UK markets contribute more than 50% of the total regulated markets contributions and Germany more than 25%. The share is expected to further increase backed by the contractual supplies and tender business respectively.

Increasing the market exposure:

✓ Progress in Europe:

The Company has spread its wings in the European markets with the focus on licensing or selling of Indoco's own intellectual property (dossiers). The filings in South Africa, Australia and New Zealand are progressing well for the company.

✓ Debut in South Africa:

South Africa is emerging as an important market for Indoco considering the future prospects. The Company has various generic companies with which it has partnered for products and dossier developments. With a dozen of products that it already supplies, it is expected to increase further due to the conscious focus on tapping this market by Indoco.

Tender business:

This is one of the important segments of the regulated markets business of the company. Indoco is in plans to increase the number of product applications in the follow up round of bidding for the tender business in markets of Germany, South Africa and New Zealand. This should provide further impetus to the business. In Germany, Indoco plans to file for new AOK tenders that are lined between March 2011-13 (5 products through its partners). In the previous round of bidding the company had filed for 2 products and received approval for one.

The supplies for the tender that was bagged in Q3FY10 from Kenya have started from February 2010. Going forward such tenders are expected from different other markets as well that are catered by the company.

Firming position in the US markets-Ophthalmic on its own:

Indoco has commissioned a dedicated ophthalmic facility that would cater to the regulated markets and is expected to go on-stream from FY12E. This step has been taken as the company plans to file ANDAs and enter into the US markets (mainly caters to the ophthalmic space) which did not contribute substantially owing to the slowdown in business from its US partner Amneal Pharmaceuticals.

This would also get a further impetus through the product development alliance that the company has recently entered into with **WATSON** for seven sterile products which includes ophthalmic products as well.

To Capture the Semi-regulated market opportunities:

In the semi-regulated markets that Indoco caters to namely CIS, Latin America, Africa and South East Asia, receivables have always been an issue. These markets have the major hurdle of payment related issues. To deal with these the company is venturing into tender based business model and partnerships/alliances for better placing in these markets and further penetration.

Besides the core business, Indoco has also entered into new dossier licensing and supply deals with Watson Inc. (WATSON) and Aspen Pharmacare (ASPEN) in Q4FY10. Both these deals are the key growth drivers for Indoco post FY12E once all the approvals and other regulatory issues are in place.

Deal with Watson:

Indoco entered into an alliance for generic product development with WATSON for seven sterile products in Feb, 2010 having a market size of ~USD 679 mn. The deal includes ophthalmic and a few patented products also.

Details of the deal:

As per the deal, Indoco will develop, manufacture and supply products to Watson for the US market. It will continue to own the technology and all from non-infringing process development to research and the manufacturing as well as the compilation of the dossiers would be done by Indoco whereas WATSON will file the Abbreviated New Drug Applications (ANDAs) for USFDA approval and will have rights to market, sell and distribute these products. The filing and promotion, marketing and distribution will be done by Watson. The filings have already begun and it is expected that the approvals should start coming in from FY13E. The Company has however started receiving milestone payments. Considering that the USFDA's time lag for approvals, the company should start clocking revenues over a period of 2 years. There are small contributions expected to come in 2011 as milestones against the development and filing undertaken by Indoco, however the real benefits adding to the margins of the company would be from 2012. (Source: Company)

About Watson:

Watson Pharmaceuticals, Inc., headquartered in Corona, California, is a leading global specialty pharmaceutical company and the third largest generic company in the US. Its business includes the development, manufacturing, marketing and distribution of generic pharmaceuticals and specialized branded pharmaceutical products mainly focusing on the Urology and Women's Health segment. It has a strong and varied product basket and operations in well-established and emerging markets. Watson has commercial operations in many of the world's established and growing international markets. It is constantly striving to enhance its position in global generics market, achieving cost efficiency and building up a pipeline of target products in generic brands and bio-pharmaceuticals that will help it deliver in the long run. (Source: Company Website)

Deal with Aspen:

Indoco entered into a dossier licensing and supply deal with Aspen Pharmacare, South Africa for supply of 7 ophthalmic products to 30 emerging countries in March, 2010. Under the agreement, Indoco will licence out the technology and supply the products. Aspen will market the products in emerging markets. It is expected that the arrangement would boost sale proceeds of the Company. ASPEN is in the process of getting the regulatory approvals.

About Aspen:

Aspen, ranking among the top 20 generic manufacturers globally, places itself as Africa's largest pharmaceutical company. It is a supplier of branded and generic pharmaceuticals in approximately 100 countries across the globe and of consumer and nutritional products in selected territories. Aspen has production capabilities for a range of products including tablets, capsules, steriles, injectables, oral contraceptives, penems, infant milk formulations, lyophilized vials, cytotoxics, suppositories, vials, fine chemicals, form-filled seals, liquids and semi-solids. It is one of the leading global players in generic anti-retrovirals. The products are known for their quality, efficacy and affordability backed by strong R&D (team of skilled and well experienced scientists that work on these products) and collaborations with other global players. (Source: Company website).

Furthermore, the export formulations business of Indoco will be further boosted by dossier licensing incomes from WATSON and ASPEN during FY11E and FY12E. Thus, Indoco is all set to benefit from the deals in the long run.

Other Target markets:

Indoco has decided to venture into countries like Cameroon, Angola, Gabon and Colombia to capitalize on the opportunities offered by emerging markets. The company will be targeting revenues of over USD1 mn by launching products in niche areas of ophthalmic antibiotics and anti-glaucoma products in Colombia, where the total market size is USD 2 bn. In the Cameroon market (~USD200mn), Indoco is registering nine products in therapeutic categories. Indoco plans to capture a considerable share in the Cameroon market over the next 2-3 years.

The registration process of 17 products in Phillipines is nearing completion and expected to start commercial supplies by early 2011.

Second Line of Business: API (Active Pharmaceutical Ingredients):

The Second line of business for Indoco is the API manufacturing that it offers to the domestic as well as the international markets. The Company has recently completed the expansion at its API facility at Patalganga. Besides the markets that it caters to, the API segment also contributes to the cost efficiency of the formulation business as it serves for captive consumption. The Company has 8 USDMFs and 5 CEPs (Certificate of Suitability) with many other projects under development and regulatory submissions.

Product Profile:

Through its different marketing divisions, the company caters to different therapeutic segments each of which has key brands to offer. With regards to its top brands, the top 12-13 products contribute around 60% of the total revenues.

Chart 8: Key Therapeutic Areas

Major therapy Areas	
Therapeutic Segment	Contribution
Anti-infectives	21%
Dental	15%
Respiratory & Anti-allergy	19%
Alimentary Systems	13%

Source: Company

DPCO (Drug price Control Order) hurdle: Of the total product profile, 12% by value is under the DPCO bracket. Only one of the top brands, namely Vepan falls under the DPCO control which had discouraged the company from promoting the brand. However, it would now be back on the promotional radar as the raw material suppliers for the product have agreed to give further discounts to the company. This has made the supply of Vepan viable for Indoco and should again start contributing to the top line of the company.

Chart 9: Major Brands of the Company

Leading brands		
Product basket	Category	Brand Value (In Mn)
Cyclopam	Antiplasmodic	278
Febrex Plus	Anti-Cold	316
Vepan	Anti-infective	167
Sensodent	Dental	214
ATM	Anti-infective	154
Oxipod	Anti-infective	121
Clamchek	Anti-infective	44

Source: ORG DATA

Chart 10: Therapeutic Performance (In ₹mn)

Particulars	Apr-Mar 10	Contribution (%)
Anti-infective	584	21
Resp & Anti-allergy	521	19
Dental	420	15
Alimentary Systems	369	13
Ophthalmic/ENT	152	6
Anti-Diabetic	135	5
Dermatology	133	5
Nutrition	132	5
Urinary	96	4
Analgesics & Antipyretics	73	3
Cardiovascular System	73	3
Anti-haemorrhagics	38	1
Musculo-skeletal disorders	14	0.49
TOTAL	2740	100

Source: Company

Recent Reporting of product performance: (In ₹ mn)

Particulars	Apr-Jun 10	Apr-Jun 09	Growth
Anti-infective	12595	12051	5%
Stomatologicals	11918	9613	24%
Gastro Intestinal	11853	11378	4%
Respiratory	10756	10264	5%
Gynaec	5255	4652	13%
Ophthal / Otologicals	4263	3605	18%
Vit / Minerals / Nutrients	3742	3147	19%
Pain / Analgesic	3737	3352	11%
Diabetic & Cardiac	5343	6526	-18%
Dermatology	3455	3294	5%

Source: Company

Product Pipeline:

The bio equivalence study for the anti-psychotic formulation has been cleared thus paving way for dossier filing in Australia and South Africa. The plan to file this dossier in EU and US is being taken further in view of the expected positive move of bioequivalence studies with the product in reference to the Australian markets. The bio studies for a cholesterol lowering formulation is in progress and the results will be known by Q2-Q3 FY11E.

R&D Activities:

Indoco has a state-of-the art R & D centre located at Rabale, Navi Mumbai where it undertakes formulation development, API research and regulatory activities. Indoco's specialization includes New Drug Delivery Systems (NDDS) and Technology Platforms for finished dosages and noninfringing processes for APIs and Intermediates. The company has over 50 scientists that are estimated to go to 90-95 gradually. It has 926 formulation dossiers of 161 products submitted to 54 countries. Indoco has submitted 20 dossiers to the European authorities and is developing 22 more dossiers for the European markets. It has submitted 8 DMF with USFDA and 1 to Canadian drug authorities. It has submitted 20 dossiers to 50 customers in Europe, Australia, New Zealand and S. Africa. (Source : Company)

Chart 11: Regulatory Status of the Company

Regulatory Status	
API	
DMF/CoS filing status:	
Project Status	No of Projects
US DMF	8
Canada	1
Cyprus	1
US DMF under progress	1
EU DMF under progress	4
COS approval received	5
Finished Dosages	
Dossier Filing Status:	
Project Status	No of Projects
US ANDA	3
EU CTD	20
Emerging Market	961
US ANDA under progress	3
EU CTD under progress	8
Emerging Market under progress	20

API	
Patents filed till date	No of Patents
India	12
PCT application	6
Finished Dosages	
Patents filed till date	No of Patents
India	13
PCT application	-

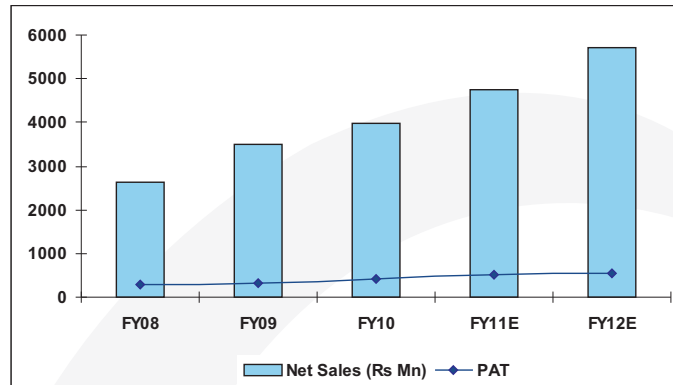
Source: Company

During the next couple of years, Indoco plans to have a dozen ANDA's filed in its name. The company is also contemplating on its plans to register its own dossiers in Europe through DCP (Decentralized Procedure) & MRP (Mutual Recognition Procedure).

FINANCIALS:

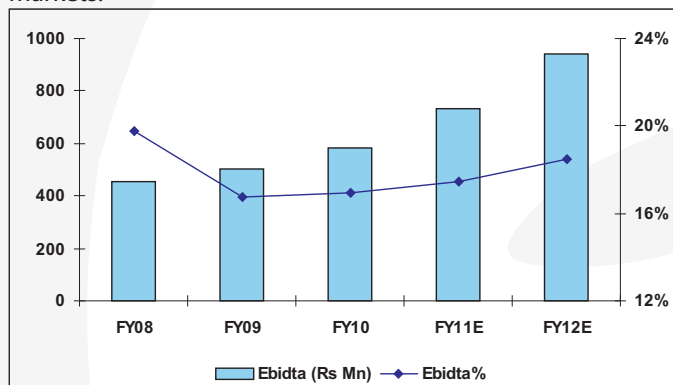
On the Growth track:

We expect the topline of the company to grow at approximately 19% in FY11E followed by 20% in FY12E. This would be attributed by multiple factors such as growth across the business segments namely Formulations and API space, new product launches and new markets to be catered.



Source: Company, GEPL Research

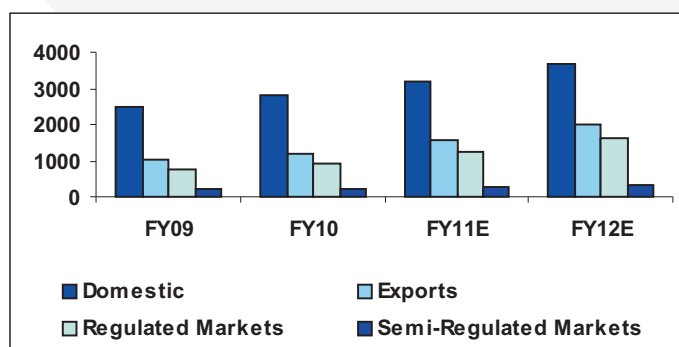
Ebitda Performance: The Company is expected to report expansion in its margins led by better product mix, higher contribution from the domestic and export formulations and increase in the share of regulated markets.



Source: Company, GEPL Research

Growth maintained through the base business:

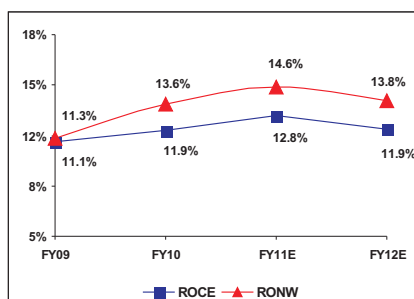
The base business of the company would remain the key factor for growth, a combination of the domestic divisions as well as the export business. The strategies to capture the regulated markets are in place. The base business through the semi-regulated markets would remain flat due to the payment issues in selected CIS countries which is being addressed by the company, sorting measures to insulate itself from this dependency by adopting the tender business model and entering into partnership as mentioned earlier.



Source: Company, GEPL Research

Expected Return Ratios:

We expect Indoco to report RoNW of 15% in FY11E and 14% in FY12E. Moreover, better operating performance and higher profit generation would lead to better RoCE as well going forward. We expect the RoCE to increase to 13% in FY11E and 12% in FY12E.



Source: Company, GEPL Research

Savings on power:

The Company has been facing high power costs due to higher tariffs from the existing supplier. However, to curb this and with the perspective to enhance its operating efficiency, the Company is now shifting to State Electricity Board for its Goa plant being in the process for approvals. Indoco estimates to have an annual saving of ₹30-40 mn by doing this. It should further help in the margin enhancement for the company.

Peer Comparison:

There are no such direct peers for the company, however across the different business segments there could be an indirect comparison with companies like Unichem Laboratories (Formulations and API manufacturer) and FDC (into the bulk drugs, formulations and API space). Elder Pharma (API manufacturer) is also another company that can be an indirect peer for Indoco.

Key Risks:

Impact due to exchange fluctuations: With increasing growth in the exports business there is a gradual increase in the exposure of the company to forex transactions and currency related risks. However, the company is taking initiatives to hedge using forward contracts.

Price Control: Currently Indoco is complying with the prices fixed for its product basket by the DPCO. However, any further reduction in these prices or addition of newer products under the DPCO cover would affect the revenues and margins of the company.

Delay in execution of contracts: Key to profitability is execution and timely delivery of products to clients. Any delay in execution of contracts will have impact on revenue and profitability.

Sustainability of the partnership model: Indoco had a muted JV with Amneal pharma for ophthalmic products wherein the deal is trimmed to a limited few products. Any such outcomes in terms of the deal signed with Watson and Aspen could hamper the earnings going forward.

Valuations and Comments:

With the backing of the marketing divisions, Indoco has a strong foothold in the domestic markets. Through these divisions, the company serves a huge doctor's base catering to a wide range of therapeutic segments. Besides this, on the international front, along with the traditional business model, the company has entered into alliances with MNCs in order to add new customers and markets to its kitty. The signing of the contracts has established the company's credentials as a reliable service provider for finished dosage forms. (FDFs).

Maintaining a positive outlook on the company with the triggers being the potential upside from strong growth in the domestic market, long-term contracts with Watson and Aspen and growth expected from the global markets we initiate a **BUY** rating on Indoco Remedies Ltd with the **target of ₹578** over the next 12 months.

We have valued the company on the basis of the PER valuation methodology. At a CMP of ₹448, the stock is trading at 11x and 10x its FY11E and FY12E EPS of ₹42 and ₹44 resp. Our one year price target of ₹578 for Indoco would provide 29% upside from current levels.

FINANCIAL OVERVIEW

Profit and Loss statement

<i>(Amount in ₹ in Mn)</i>	FY08	FY09	FY10	FY11E	FY12E
Net Sales	2627	3506	3983	4759	5705
Growth %	-	33.5%	13.6%	19.5%	19.9%
Total Operating Income	2652	3546	4033	4812	5762
Total Expenses including R&D	2199	3044	3452	4081	4820
Total Expenses excluding R&D	2127	2952	3350	3970	4699
EBITDA including the R&D expenses	453	501	581	731	942
EBITDA %	17.1%	14.1%	14.4%	15.2%	16.4%
EBIDTA exclusive of the R&D expenses	525	594	684	841	1063
EBITDA %	19.8%	16.7%	16.9%	17.5%	18.5%
Depreciation & Amortisation	78	112	121	158	194
R&D expenses	72	92	102	111	121
Other Income	3	5	2	0	0
Other Operating Income	22	34	49	52	58
EBIT	375	390	460	573	749
Less: Gross Interest	36	58	29	42	40
Recurring Pre-tax Income	339	331	431	531	709
Extra Ordinary items	-18	0	0	0	0
Taxation	19	17	10	16	163
Net Income	301	314	421	516	546
NPM %	11.3%	8.9%	10.4%	10.7%	9.5%
Adjusted PAT	301	314	421	516	546
Basic Earning Per Share (Rs)	26	26	34	42	44
Diluted Earning Per Share (Rs)	25	26	34	42	44

Source: Company, GEPL Research

*Due to the change in accounting year FY-08 operations are comprised of nine months.

*The Company reports the Ebidta exclusive of the R&D expenses. However, the Ebidta inclusive of the R&D expense is also mentioned in the report for clarity.

Balance Sheet

<i>(Amount in ₹ mn)</i>	FY08	FY09	FY10	FY11E	FY12E
SOURCES OF FUNDS					
Share Capital	123	123	123	123	123
Reserves & Surplus	2420	2662	2982	3397	3842
Net Worth	2542	2784	3105	3520	3965
Total Borrowings	343	557	660	935	803
Deferred Tax Assets	15	16	13	13	13
Deferred Tax Liabilities	234	246	255	255	255
Total	219	230	243	243	243
TOTAL	3104	3572	4008	4697	5011
APPLICATION OF FUNDS					
Total Fixed Assets	1734	1922	2279	2766	3072
Total Investments	0	0	0	0	0
Total Current Assets	1991	2233	2511	2970	3337
Total Current Liabilities and Provisions	626	585	783	1040	1400
Net Current Assets	1365	1648	1728	1930	1938
Miscellaneous expenditure	4	1	1	1	1
Total Assets	3104	3572	4008	4697	5011

Source: Company, GEPL Research

Cash Flow Statement

<i>(Amount in ₹ mn)</i>	FY08	FY09	FY10	FY11E	FY12E
PBT	339	331	431	531	709
Add:					
Depreciation & Amortisation	78	112	121	158	194
Other Adjustments	33	34	(4)	42	40
Operating Cash Flow before WC change	450	477	548	731	942
Cash generated from Operations	295	377	478	698	862
Net Cash flow from Investing Activites	(143)	(286)	(467)	(645)	(500)
Net Cash flow from Financing Activites	(144)	38	74	132	(272)
Total Increase / (Decrease) in Cash	7	129	85	186	90

Source: Company, GEPL Research

Ratio Analysis

Ratio Analysis	2008	2009	2010	2011E	2012E
Earning per share (EPS)	26	26	34	42	44
Diluted Recurring Earnings per share	24	26	34	42	44
Reported Book Value (BV)	207	227	253	286	323
Dividend per share	5	2	7	7	7
Valuation Ratios (x)					
Diluted Price Earning Ratio	17	17	13	11	10
Price to Book Value	2	2	2	2	1
Price/sales	0.2	0.1	0.1	0.1	0.1
EV / EBITDA	13	12	10	8	6
Growth Ratios (% YoY)					
Diluted Recurring EPS Growth	-	-2%	34%	22%	6%
Total Operating Income Growth	-	34%	14%	19%	20%
EBITDA Growth	-	11%	16%	26%	29%
Net Sales	-	34%	14%	19%	20%
Operating Ratios (%)					
EBITDA Margin (incl of R&D)	17%	14%	14%	15%	16%
EBITDA Margin (excl of R&D)	20%	17%	17%	17%	18%
EBIT Margin	14%	11%	11%	12%	13%
Recurring Net Income Margins	11%	9%	10%	11%	9%
Effective Tax Rate	6%	5%	2%	3%	23%
Return / Profitability Ratios (%)					
Return on Capital Employed (RoCE)	-	11%	12%	13%	12%
Return on Assets	0%	9%	11%	12%	11%
Return on Net Worth (RoNW)	12%	11%	14%	15%	14%
Solvency Ratios / Liquidity Ratios (%)					
Debt Equity Ratio (D/E)	0.2	0.3	0.3	0.3	0.3
Current Ratio	2.3	2.4	2.3	2.1	1.8
Turnover Ratios					
Inventory Turnover Ratio (x)	-	2.5	2.5	2.4	2.5
Assets Turnover Ratio (x)	-	1.1	1.1	1.1	1.2

Source: Company, GEPL Research

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