

INDOCO REMEDIES LTD.

INITIATING COVERAGE

OUTLOOK FOR THE COMPANY

Indoco Remedies Ltd (IRL) currently trades at attractive valuations considering its recent alliances with global Pharma majors and expected growth going forward. IRL generates 98.0% of its revenues from Formulation business and balance from API business. IRL has significant international presence with approximately 23.0% of the revenues coming from exports. IRL has recently tied up with Watson Pharma for supply of generic products to US, the market size of which is USD679 mn. It has also tied up with Aspen to deliver products to U.K, Africa and Rest of the World. These tie-ups are expected to be the next drivers of growth for IRL post FY 2012. **We Recommend Investors to ACCUMULATE the stock at current levels for initial Price target of Rs.587.**

INVESTMENT RATIONALE

- We expect IRL to achieve 29.2% and 19.2% y-o-y growth in Sales in FY 2011 and FY 2012 respectively. This would be driven by entry into new markets, contribution from new products and doubling of API sales.
- We expect improvement in IRL margins due to its shift to State Electricity Board to supply power to Goa Plant and due to economies of scale.
- IRL recently tied up with Watson Pharma to sell generic drugs in USA. The size of this market is USD679 mn and company would start achieving revenues for the same by FY 2013-14.
- To increase presence in Africa and UK, IRL tied up with Aspen to market and sell generic drugs. This would significantly increase its presence in international market as Aspen is the largest Pharma manufacturer in Africa.
- IRL is expected to incur capex to tune of Rs.900 mn particularly for new plant in Goa and modernization of existing facilities.
- IRL currently trades at attractive P/E multiple of 7.3 on FY 2012E EPS of Rs.65.2 and P/Sales of 0.9 on FY 2012E Sales.

PHARMACEUTICAL

June 21, 2010

ACCUMULATE

| | |
|--------|--------|
| CMP | Rs.479 |
| Target | Rs.587 |

SHARE HOLDING (%)

| | |
|-----------------|-------|
| Promoters | 60.47 |
| FII/NRI | 3.49 |
| FI/MF/CB's | 9.65 |
| Non Promoter | 1.9 |
| Public & Others | 24.5 |

STOCK DATA

| | |
|-----------------------|------------------------------|
| Reuters Code | INRM. BO |
| Bloomberg Code | INDR IN |
| BSE Code | 532612 |
| NSE Symbol | INDOCO |
| Market Capitalization | RS. 5,885.5mn US\$127.9mn |
| 52 Weeks (H/L) | RS.487/157 |

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KEY FINANCIALS

| Y/E March. | Revenue (Rs mn) | APAT (Rs mn) | AEPS (Rs) | AEPS (% Ch.) | P/E (x) | ROCE (%) | ROE (%) | P/BV (x) | P/Sales (x) |
|---------------|--------------------|-----------------|--------------|-----------------|------------|-------------|------------|-------------|----------------|
| FY09 | 3,552.6 | 314.4 | 25.6 | (24.5) | 18.7 | 26.5 | 22.6 | 2.1 | 1.7 |
| FY10E | 4,023.6 | 420.9 | 34.3 | 33.9 | 14.0 | 14.8 | 14.3 | 1.9 | 1.5 |
| FY11E | 5,200.0 | 594.6 | 48.4 | 41.3 | 9.9 | 17.5 | 17.7 | 1.6 | 1.1 |
| FY12E | 6,200.0 | 801.3 | 65.2 | 34.8 | 7.3 | 19.8 | 20.5 | 1.4 | 0.9 |

COMPANY OVERVIEW

Indoco Remedies Limited is involved in manufacturing and marketing of API, Formulations and Advance Drug Intermediates. It has been successful in becoming the preferred choice for Contract Research and Manufacturing Services (CRAMS). IRL has strongly placed itself with a portfolio of 200 products in various therapeutic segments including anti-infective, anti-cold, ophthalmic, anti-spasmodic, stomatology, anti-inflammatory, anti-fungal and has strong visibility in high growth lifestyle segments like Anti- Diabetics, Cardiovascular, Central Nervous System, Musculo-Skeletal, Nutrition and Dental Care also. The company has been ranked 22nd by prescription audit of ORG-IMS (April 2010).

Products

Indoco Remedies, in recent years have grown on the back of expansion of production facilities and introducing new products in various therapeutic segments. It has been successful in launching 13-15 new products every year, out of which 3-4 brands become significant contributor to revenues. Its top 12-13 brands generate approximately 60.0% of total revenues. The branded products are definite to grow at 15% for the next few years.

| Brand Portfolio | Category | Value |
|-----------------|------------------|---------|
| Brands | | Rs (Cr) |
| Febrex Plus | Anti – cold | 35 |
| Cyclopam | Antispasmodic | 36 |
| Vepan | Anti – infective | 27 |
| ATM | Anti – infective | 16 |
| Sensodent | Dental | 27 |
| Oxipod | Anti – infective | 11 |
| Clamchek | Anti – infective | NA |

Source: As per ORG Sept. 09

Manufacturing and R&D Facility

At present, Company has four manufacturing facilities and a fully equipped R&D centre.

Goa Plant 1 - The solid dosage facility has been accredited by UK-MHRA, MCC-South Africa, TGA- Australia, ANVISA-Brazil and Darmstadt Germany. It is also designed for US FDA approval in case the company decides to apply for the same.

Goa Plant 2 - The sterile plant for Ophthalmic and Injectibles has been approved by US FDA, MCC, South Africa and EU Authorities.

Baddi Plant - The new facility will help the company to fulfill formulations requirements in domestic and international markets. It is approved by UK-MHRA for solid dosages.

Waluj Plant - The facility is for solid and liquid orals and external preparations. It caters to the needs of Domestic Formulation Business and also caters for ROW markets.

API Plants - Patalganga plant is US-FDA approvable and has recently undergone expansion and modernization.

Rabale Centre - The R&D centre and Kilo lab facility is US-FDA approvable. It has strengthened the company to cater to the requirements of regulated markets for CRAMS.

Strong Marketing and Distribution Network

Domestic Focus

In the domestic space, the company has in place five marketing divisions concentrating on different therapeutic segments with the help of 35 CNF and 1600 Medical Representatives.

- Indoco
- Spade
- Warren
- Excel
- Spera

Two new divisions have now been established for reaching the extra urban markets and untapped territories. These include 'Xtend' which would focus on tapping extra urban populations and 'Eterna' which would be a division of chronic therapy covering physicians.

International Focus

On the Global front, in non regulated markets products are sold on Indoco brand while in regulated markets, company ties up with big Pharma companies for marketing.

IRL has tied up with Watson and Aspen in 2010 to market its product in US, Africa, U.K and other geographies. By such tie up company is able to increase its presence in regulated markets and thus able to increase its market share at global level.

INDUSTRY OVERVIEW

The Indian Pharmaceutical market is estimated to touch USD30.0 bn by 2030. India currently holds the 13th position in the world in terms of value and 4th position in terms of volume. Indian Pharmaceutical Market has grown at a CAGR of 13.0% during the last 4 years. ORG-IMS expects it to grow between 10-12% in FY 2010 and 13-14% in the next few years.

With slowdown in US and European economies, Emerging economies are expected to be the next driver of growth. Indian economy with strong GDP growth and large population now covered under health care coverage would prove to be significant growth driver for companies like IRL.

The global pharmaceutical market in 2010 is projected to grow 4 - 6% exceeding USD825 bn through 2013. This industry growth is driven by stronger near-term growth in the US market and is based on the global macro economy, the changing combination of innovative and mature products apart from the rising influence of healthcare access and funding on market demand.

IRL with its tie-up with Watson Pharma and Apsen is expected to increase its presence in US markets and Rest of the World. It would thus be able to cash in on the growth expected in developed global economy as well as emerging markets.

INVESTMENT THESIS

Multiple factors to boost Top-Line Growth in next few years

We expect IRL to grow at 30.0% y-o-y during FY 2011 and approximately 20.0% y-o-y in FY 2012. IRL is very much on track to achieve this growth due to multiple factors. IRL is expected to ramp up its API supply which is expected to double its API turnover from approximately Rs.180 mn in FY 2010 to approximately Rs.400 mn in FY 2011. Its exports from Formulation business is expected to increase from Rs.1,180 mn in FY 2010 to Rs.1,500 mn in FY 2011. We expect IRL's new products to contribute roughly Rs.350 mn to FY 2011 revenues. With a focus on increasing its market, IRL has started two new marketing divisions which would help IRL enter into new territory. This is expected to contribute roughly Rs.250 mn to FY 2011 revenues.

Strong brand portfolio to maintain revenue visibility

More than 60.0% of IRL top-line is driven by top 12 brands. The Company's focus has been to concentrate on these star brands as they have significant potential to grow as IRL enters into untapped markets. Out of its top brands only Vepan comes under drugs price control order (DPCO) due to which IRL had stopped promoting this particular brand. This led to de-growth in Sales for this particular brand in 2010 where all other brands experienced y-o-y growth. IRL has now decided to start promoting Vepan again as it now receives further discounts from the raw material suppliers for this brand. It has now become viable for the company to supply Vepan. We expect to see a growth in FY 2011 for Vepan and thus contribute to the overall top line growth of IRL.

Expected Weakness in USD and expected decline in power costs to drive Operating Margins going forward

IRL imports approximately 10.0% of its raw material requirements and its domestic suppliers also depend on imports from China. Currency plays a crucial role in determining the prices. During FY 2010, material prices had gone up mainly due to the stronger USD. So far in FY 2010 IRL USD has weakened and we expect this weakness to continue for the next few quarters.

IRL so far has been facing high power costs due to higher tariffs from the existing supplier. The Company is now shifting to State Electricity Board for its Goa plant and the shift is expected to complete by July 2010. This decline in power costs would lead to decline in operating costs and thus we expect operating margins in FY 2011 to reach 15.5% from 14.4% achieved in FY 2010.

Increasing presence in US markets through Watson tie up to drive growth beyond FY 2012

IRL entered into an alliance with Watson Pharma in early part of 2010. Under this deal, IRL will develop, manufacture and supply sterile products that currently have market size of USD679 mn at present. This deal mainly includes generic products and Watson Pharma would file for ANDA for US FDA approval and then market and sell the products manufactured by IRL in the US markets. The costs, risks and profits would be shared between the two parties.

This deal would give IRL increasing presence in US market. The revenues from this deal would be flowing in FY 2013-14. However 20.0% of the milestone payments for dossier development has already been received by IRL and would be accounted for in FY 2011. IRL has already filed its first ANDA and expects to file one ANDA in every two three months.

Aspen Deal to increase presence in UK, South Africa and Rest of World

In 2010, IRL has entered into a licensing and supply agreement with Aspen Pharma, which is the largest pharmaceutical manufacturer in Africa. Aspen also is one of top twenty largest generics manufacturers in the world with 30.0% generic market share in South Africa. IRL would supply ophthalmic products to Aspen which would then be marketed and distributed by Aspen in different geographies after Aspen receives regulatory approvals for marketing the same.

IRL expects stronger presence in UK, South Africa and Rest of the World with this deal.

Capacity expansion going forward by setting up new facility and expanding existing facility

IRL expects to incur capex to the tune of Rs.900 mn during FY 2011. It is setting up a new plant in Goa where it would allocate Rs.480 mn. This is expected to double its tablet manufacturing capacity to 8 bn per annum. IRL would also spend on modernization and expansion of its Baddi and Waluj facility. Some portion of the Capex would also be spent towards its R&D facilities.

Risk Factors

- Few of IRL's products are under DPCO and thus the margins for the same get affected to pricing restrictions. If going forward, more products are added to DPCO then it could affect the margin performance for IRL.
- IRL's export turnover is approximately 23.0% of the total turnover. IRL has hedging strategies in place to some extent. If exchange rates move against IRL's expectations then it could significantly impact its bottom line performance.
- IRL has been affected in the past due to fluctuation in exchange rates which affect the prices of its raw materials. If exchange rates move against IRL expectations, it could increase prices of its raw materials going forward thus impacting its margin performance.

PROFIT & LOSS STATEMENT

(Rs.mn)

| Y/E March | FY09 | FY10E | FY11E | FY12E |
|-----------------------|----------------|----------------|----------------|----------------|
| Net Sales | 3,506.3 | 3,983.4 | 5,148.0 | 6,138.0 |
| Raw material Cost | 1,495.7 | 1,742.4 | 2,214.4 | 2,640.3 |
| Personnel Exp. | 479.4 | 564.2 | 648.8 | 746.2 |
| Other Operating Costs | 976.8 | 1042.5 | 1406.8 | 1677.3 |
| R&D Expenses | 92.3 | 102.2 | 130.3 | 155.3 |
| PBIDT | 495.9 | 580.4 | 810.1 | 993.3 |
| Interest Cost | 58.5 | 29.1 | 44.2 | 44.2 |
| Depreciation | 111.6 | 121.0 | 171.2 | 147.8 |
| Other Income | 5.5 | 1.6 | 0 | 0 |
| Extraordinary Exp. | 0.0 | 0.0 | 0.0 | 0.0 |
| PBT | 331.4 | 431.9 | 594.6 | 801.3 |
| Tax | 17.0 | 11.0 | 0 | 0 |
| RPAT | 314.4 | 420.9 | 594.6 | 801.3 |

FINANCIAL RATIO STATEMENT

| Y/E March | FY09 | FY10E | FY11E | FY12E |
|-----------------------------|-------|-------|-------|-------|
| Growth Ratios (%) | | | | |
| Net Sales | 33.5 | 13.6 | 29.2 | 19.2 |
| EBITDA | 15.4 | 17.0 | 39.6 | 22.6 |
| APAT | (1.3) | 33.9 | 41.3 | 34.8 |
| Profitability (%) | | | | |
| EBITDA Margin (%) | 14.0 | 14.4 | 15.5 | 16.0 |
| Net Profit Margin (%) | 8.9 | 10.4 | 11.4 | 12.9 |
| ROCE (%) | 26.5 | 14.8 | 17.5 | 19.8 |
| ROE (%) | 22.6 | 14.3 | 17.7 | 20.5 |
| Per Share Data (Rs.) | | | | |
| EPS | 25.6 | 34.3 | 48.4 | 65.2 |
| CEPS | 35.5 | 45.0 | 62.3 | 77.2 |
| BVPS | 226.6 | 260.9 | 309.3 | 374.5 |
| Valuation Ratios (x) | | | | |
| PER | 18.7 | 14.0 | 9.9 | 7.3 |
| P/BVPS | 2.1 | 1.9 | 1.6 | 1.4 |
| EV/EBITDA | 13.0 | 11.1 | 8.3 | 6.8 |
| P/Net Sales | 1.7 | 1.5 | 1.1 | 0.9 |
| Turnover Days | | | | |
| Debtors Days | 52 | 79 | 75 | 71 |
| Creditors Days | 64 | 65 | 65 | 65 |

Source: Company, Sushil Finance Research Estimates

BALANCE SHEET STATEMENT

(Rs.mn)

| As on 31 st March. | FY09 | FY10E | FY11E | FY12E |
|-------------------------------|----------------|----------------|----------------|----------------|
| Share Capital | 122.9 | 122.9 | 122.9 | 122.9 |
| Reserves & Surplus | 2,661.6 | 2,996.5 | 3,472.2 | 4,113.2 |
| Net Worth | 2,784.4 | 3,119.3 | 3,595.1 | 4,236.0 |
| Secured Loans | 397.6 | 397.6 | 697.6 | 697.6 |
| Unsecured Loans | 157.9 | 157.9 | 157.9 | 157.9 |
| Total Loan funds | 555.5 | 555.5 | 855.5 | 855.5 |
| Deferred tax liabilities | 230.0 | 230.0 | 230.0 | 230.0 |
| Capital Employed | 3,570.0 | 3,904.8 | 4,680.5 | 5,321.6 |
| Net Block | 1,759.4 | 1,938.4 | 2,567.1 | 2,619.3 |
| Cap. WIP | 162.8 | 162.8 | 162.8 | 162.8 |
| Investments | 0.2 | 0.2 | 0.2 | 0.2 |
| Sundry Debtors | 1,003.3 | 862.2 | 1,057.8 | 1,194.0 |
| Cash & Bank Bal | 290.2 | 593.4 | 552.1 | 1,014.3 |
| Loans & Advances | 415.1 | 415.1 | 415.1 | 415.1 |
| Inventories | 524.8 | 305.5 | 382.2 | 448.5 |
| Curr Liab & Prov | 587.3 | 374.2 | 458.2 | 534.1 |
| Net Current Assets | 1,646.2 | 1,802.1 | 1,949.0 | 2,537.9 |
| Total Assets | 3,570.0 | 3,904.8 | 4,680.5 | 5,321.6 |

CASH FLOW STATEMENT

(Rs.mn)

| Y/E March | FY09 | FY10E | FY11E | FY12E |
|-----------------------------------|----------------|----------------|----------------|----------------|
| PBIT | 331.4 | 459.4 | 638.8 | 845.5 |
| Depreciation | 111.6 | 121.0 | 171.2 | 147.8 |
| Forex (Net) | (17.7) | 0 | 0 | 0 |
| Other | 51.8 | (27.5) | (44.2) | (44.2) |
| Chg. in WC | (46.7) | 147.3 | (188.3) | (126.6) |
| Direct Tax | (52.7) | (11.0) | 0 | 0 |
| Cash Flow from Operations | 377.6 | 689.2 | 577.6 | 822.5 |
| Chg. In Fixed Assets | (289.9) | (300.0) | (800.0) | (200.0) |
| Chg. In Investment | (0.2) | 0.0 | 0.0 | 0.0 |
| Cash Flow from Investing | (286.3) | (300.0) | (800.0) | (200.0) |
| Chg In Debt | 212.7 | 0.0 | 300.0 | 0.0 |
| Interest | (56.7) | 0.0 | 0.0 | 0.0 |
| Dividend | (118.3) | (86.0) | (118.9) | (160.3) |
| Cash Flow from Financing | 37.7 | (86.0) | 181.1 | (160.3) |
| Cash & Cash Equivalent | 290.2 | 593.4 | 552.1 | 1,014.3 |

OUTLOOK & VALUATION

Indoco Remedies Limited is involved in API, Formulation and CRAMS business and with a well-built brand portfolio of 200 products it caters to various therapeutic segments, including high growth life style segments such as Anti-Infectives, Anti-Diabetics, Cardiovascular, Central Nervous System, Musculo-Skeletal, Nutrition and Dental care. It derives approximately 98.0% of its total revenues from Formulations business and balance from API. It has entered into an alliance with Watson Pharma which would increase its presence in USA. It has also tied up with Aspen which has strong presence in Africa. This would give IRL higher exposure in major geographies like Africa and UK and would be a major growth going forward. At the current market price of Rs.479, IRL is available at an attractive valuation of 7.3x its FY12E EPS of Rs.65.2 and 1.4x of its FY12E Book Value. It is currently trading at 0.9x its FY12E Sales. We recommend investors to ACCUMULATE the stock at current levels with initial target price of Rs 587.(9.0x FY2012E EPS)

Please Note that our technical calls are totally independent of our fundamental calls.

Additional information with respect to any securities referred to herein will be available upon request.

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