GLOBAL AMBITION

FINDING THE RIGHT FORMULA : Indoco has changed its domestic product mix from mass to lifestyle/chronic medicines

With a diverse product mix in the domestic market, Indoco Remedies is now aggressively looking at exports to cross a topline of ₹1,000 crore

Sonia Mariam Thomas & Mahithi Pillay

Almost everybody associates Goa with sand, sunshine and *feni*, but it was also where Govind Ramnath Kare founded Indo Continental Trading Company in 1945. Its main business activity was importing pharmaceutical formulations from Europe and distributing them in western India. Even in those primitive years, Kare was soon to trip over a regulatory hurdle. After India's independence, the government banned the import of formulations in order to encourage local manufacturers. Kare was made of sterner stuff and instead of backing down decided to up the stakes. He renamed his company Indoco Remedies and turned into a manufacturer.

Since then, it has been smooth sailing for Indoco Remedies and after 67 years, the company today has a market cap of ₹2,800 crore. While the pace of growth can be argued over, the trajectory has continued to be north and Kare's granddaughter Aditi Kare Panandikar wants to keep it that way. She would only be forwarding the legacy of her father Suresh Kare who grew the company from a turnover of ₹2.5 lakh to ₹600 crore over his 50 year-tenure. Panandikar, who joined the company in 1997, took over as managing director in 2012 from her father. "We have risen from being a ₹270 crore company in FY06 to ₹850 crore now and I plan to take it to ₹1,000 crore by FY16," she says.

To power this growth, Indoco is moving from safer domestic shores to other emerging markets as well as countries such as Australia, New Zealand, South Africa and the UK. That is why the early months of 2014 were a very tense period for Panandikar. Many top notch Indian pharmaceutical companies were getting pulled up by the US FDA for procedural violations and Indoco, too, had a couple of vital FDA approvals pending. Panandikar's nervousness wasn't without reason. Indoco wants to increase exports from 35% of revenue to 45% and increased access to the US market would not only help in achieving that target but also result in increased margins. Currently, Europe accounts for the bulk of exports with the US only contributing 15%. Thankfully, in July 2014, the FDA green lighted the sterile facility (plant-II) and solid dosage facility (plant-III) at Verna.

Says Panandikar, "We went international to grow; in fact, we were probably late by a few years. But we did not jump from one business model to the other in the process. We are still partners with the company that we started off with when we began contract manufacturing, even if in a smaller capacity." And these partnerships have mostly paid off for the pharma major. "While people say that this is a competitive business where you lose people over a few pennies, we have not had that experience yet. No one will leave you if you can mutually agree on price, logistics and quality," she adds.

SOUMIK KAR

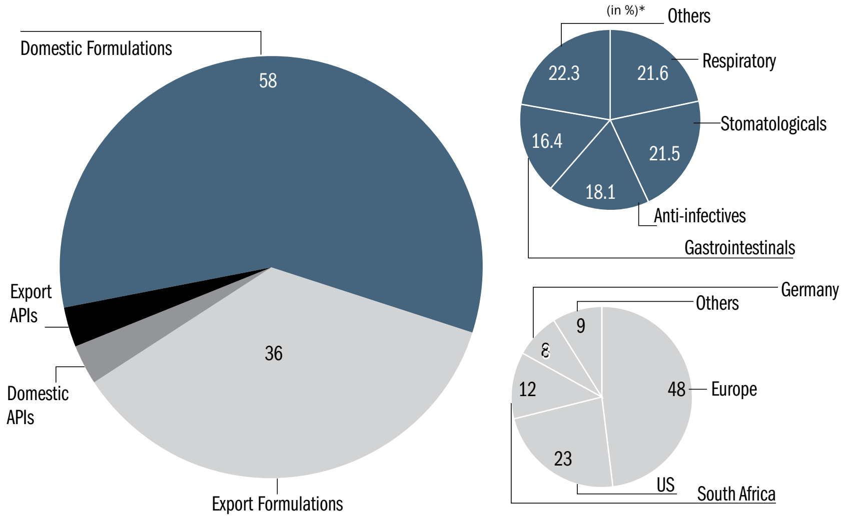
MISSION ACCOMPLISHED?

For most of its 60-odd years of existence, Indoco relied mostly on

> "In the Indian pharmaceutical industry, where you start from is where you grow best. It takes a lot of time to build brands here
>
> —ADITI KARE PANANDIKAR
> Managing director, Indoco Remedies

Spreading itself thin

Indoco caters to many categories to counter competitive and regulatory risks



Source: Anand Rathi Research (for FY15)
* estimates

Source: Destimoney Research (for FY14)

internal accruals. That changed after it went public in 2005. New shareholders did come in but the management continued with its growth template. “Even after listing, we decided to maintain our long-term growth plans instead of living from quarter to quarter, as is demanded from most listed companies,” says Panandikar.

In the past, Indoco sold mostly to general practitioners, its strength lying in the respiratory, antibiotics, dental and gastrointestinal space. In keeping with the strategic change at the senior management level about three years ago, the company has been concentrating on making the business more profitable. Building on the success of legacy products such as Sensodent-K, Cital and Febrex Plus, which already enjoy a good market share, the company has announced several brand launches and extensions, especially in the chronic section. “From being a ₹270-crore company, we wouldn’t have grown unless we pushed our top two-three brands. No amount of new product launches would have helped us. Our well-structured international strategy — right from pipeline development to infrastructure to partners — and patience has kept us going,” says Panandikar.

Indoco’s export strategy includes its move to consciously sell more API formulations. And given the positive development on the FDA front, more good news on the export front should follow. It is here that its partnership with Watson (now known as Actavis), forged in 2010 will stand it in good stead. Panandikar says, “We had started contract manufacturing in ophthalmological and realised an international foray wouldn’t have been possible on our own. So, we built a pipeline and invited Watson to our existing FDA approved site for a tie-up. They needed someone with a ready basket and low risk, so this was a good fit.” At present, while Indoco formulates and manufactures the products, Watson files ANDAs for the same.

Ashish Thavkar, senior analyst, Asian Markets Securities, is gung-ho about the Watson tie-up. “In another five to six years, when Indoco has released all 23 of its products with Watson, the potential sales may be as high as $70 million. Even in Europe, its Ebitda margin may grow to 17-18% in the coming years. The only thing that could slow its growth in the near future is if the Watson deal doesn’t pan out the way it should.”

Sriram Rathi of Anand Rathi Securities echoes the following opinion in his report, “Indoco has already experienced healthy Ebitda margin improvement to over 18%. On commencement of revenue from the Watson deal, we expect margins and return ratios to improve substantially.”

TRIPPING UP

While its international sojourn seems to be going well, one of the things to put a spanner in the works for Indoco was the national pharmaceutical pricing authority’s (NPPA) May 2014 order that enabled it to put certain life-saving drugs that were not on the national

INDOCO LAUNCHES 25-30 PRODUCTS EVERY YEAR ACROSS ALL DIVISIONS AS IT AIMS TO FILL UP THERAPY GAPS

list of essential medicines (NLEM) under price control. And, sure enough, by July, a price ceiling was announced by the NPPA on 108 non-NLEM drugs. The 348 drugs already on the NLEM 2011 list have been under price control since May 2013. Though there was an update on the NPPA order by September, most pharma companies were understandably spooked. Panandikar, however, remains unfazed. "The NLEM taught us to be derisked. When the drug price control order (DPCO) was put in place, we took a conscious decision to not put all our eggs in one basket, so that we could cushion ourselves from such a blow in the future. Unlike us, there are many pharma companies that have parked 90% of their top brands in one category." And that's not the only area where Indoco has been beating the competition. Introducing 25-30 products every year across all divisions, the company has been working on a product mix to fill up therapy gaps. Meeta Shetty, senior research analyst, HDFC Securities, is confident

Winning partnership

The US FDA approval for its Verna plant will result in more revenues from the Watson tie-up

PARTNER:	Watson Pharmaceuticals
MARKET:	US
OBJECTIVE:	Develop and manufacture opthalmic products, currently 23 products under development
PARTNER:	aspe
MARKET:	Africa
OBJECTIVE:	Sell solid dosages and opthalmic products, deal covers 30 countries
PARTNER:	DSM
MARKET:	Europe
OBJECTIVE:	Marketing of APIs

Source: ICICI Direct

Reason for optimism

A rise in US exports is expected to drive up the return on capital employed

	FY13	FY14	FY15*	FY16*
EBITDA margin	15	16	18	20
EBIT margin	11	11	15	17
Adjusted profit margin	7	8	12	14
Adjusted ROAE	11	13	21	25
ROCE	13	13	19	22

Source: Religare Institutional Research

Note: in %; * estimates

about the management's ability to execute. "Indoco has a great brand penetration with its top brands, so it won't matter if the company diversifies into more therapies. However, moving towards chronic diseases will definitely push their margins up. In the acute diseases segment, pharma companies need a lot of manpower and visits to doctors, as the market is very crowded. Some of these limitations will ease out in the chronic segment as it is more exclusive." Within the product basket, however, Panandikar feels that there is a lot of leveraging left to do. At present, 60% of Indoco's topline in India comes from the southern and western regions; the north and east contribute 18% each. "In the Indian pharma industry, where you start from is where you grow best. It takes a lot of time to build brands here," she adds.

DOING IT ANEW

At the moment, however, Indoco is sticking to its growth plan for the future. The aim is to reduce the contribution to revenue from domestic sales to 55% from the current 60% and increase international sales to 45%. While the company expects an overall growth of 25% (volume and value), it is sticking to its policy of not having too many eggs in one basket by driving revenue from new products and new geographies. Its own expectations from the US market are relatively modest, as Panandikar explains, "In a geography such as the US, growth rate expectations of 100% are natural because we are still very small there and are only expecting to grow. Right now, the US constitutes 15% of our international business; Europe constitutes 50% of exports."

Apart from its international move, Indoco has also made a conscious change in its domestic product mix from mass to lifestyle/chronic medicines. Though there is no singular category or medicine that Indoco is focusing on, the top four therapy areas continue to be stomatological, gastrointestinal, respiratory and antibiotics. Newer divisions include cardio-diabeto, which is what it plans to eventually build on. Each division will be assessed for standalone growth and has been given fixed operating and net profit targets. While most pharma companies either reel in customers using low prices and others have a high brand image and command premium pricing, Indoco is comfortable in the middle. "Three years ago, antibiotics accounted for almost 20% of topline revenue in domestic markets. We consciously controlled the contribution of antibiotics to our product mix, by ensuring that all our new products were not launched in this category," says Panandikar.

That said, the company is trying its best to not remain stuck in the middle. Indoco now wants to push products that give it bet-

WHILE IT PLANS TO ADD CAPACITY IN THE FUTURE, FOR NOW, INDOCO IS CONSERVATIVE WITH BORROWINGS

ter margins, though that is not an easy task, as Panandikar admits. "We are trying to get our premium products into doctors' offices. After all, prescriptions still account for about how 95% of our sales are pushed. You cannot sustain a brand for very long if you are unable to get people to sign up for it."

Another key challenge remains the uncertainty of regulatory approval timelines. "Though India accounts for a significant chunk of filings, we are getting our fair share of problems in return. The FDA is probably weighed down by a lot of pending filings as well. As a participant, I am not entirely unhappy about this situation, as it helps restrict competition. The thing is, we have all kinds of competitors; for every brand, I have two international challengers, four domestic ones and one peer for whom that brand might account for 90% of its topline."

For now, Indoco seems to be on track to achieve its target of becoming a ₹1,000-crore company by FY16. While it plans to add capacity in the future, for now, the company is conservative with borrowings and aims to maintain its capex at ₹30 crore-₹40 crore. "There is a long way for us to go. There is a decent leeway as realisations go up but some of our capacities are underutilised and we need to fill them up with domestic demand," explains Panandikar. This patience and caution is being driven by an earlier well learnt lesson. "In the past, we went through a phase of high investment and not too much return. We built plants and got approvals but the gestation period for international approvals restricted growth in that area. Nevertheless, we put these capacities to use for domestic products and will free them up to accommodate growth in our international business." Way back in 1947, Govind Ramnath Kare showed great flexibility when he moved from being an importer of formulations to a manufacturer to deal with the changing times. Panandikar will need to exhibit the same flexibility as she prepares to grow the company beyond the ₹1,000-crore milestone.