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Stock Update

Indoco Remedies Ltd.

23-August-2021

RETAIL RESEARCH

Indoco Remedies Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Pharmaceuticals	Rs 456.9	Buy in the Rs 457-462 band & add more on dips to Rs 413-419 band	Rs 506	Rs 540	2 quarters

HDFC Scrip Code	INDREMEQNR
BSE Code	532612
NSE Code	INDOCO
Bloomberg	INDR IN
CMP Aug 20, 2021	456.9
Equity Capital (Rs cr)	18.4
Face Value (Rs)	2
Equity Share O/S (cr)	9.2
Market Cap (Rs cr)	4209
Book Value (Rs)	83.5
Avg. 52 Wk Volumes	491971
52 Week High	529
52 Week Low	214

Share holding Pattern % (Jun, 2021)	
Promoters	58.7
Institutions	21.6
Non Institutions	19.7
Total	100.0

Retail Research Risk Rating:

	Blue*	

*** Refer at the end for explanation on Risk Ratings**

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Our Take:

Indoco Remedies has presence across domestic market, US and EU markets and Emerging Markets. Company has strong brands in the domestic formulations business across acute, chronic/sub-chronic segment. Indoco launched nine new products during FY21. Management has guided for robust growth in FY22; the company has already registered strong revenue in Q1FY22. US business is expected to grow at robust pace as ANDAs will be commercialized at regular intervals. US revenue in FY21 had surged by 162% YoY at Rs 148cr on a low base in FY20. Management has guided for around Rs 250cr revenue from US market for FY22.

Indoco is expected to post strong growth in India business due to opportunities arising from Covid portfolio and led by new launches in FY22. Company offers medicines in therapeutic areas such as stomatology, respiratory, ophthalmology, Gastro-Intestinal, Vitamins, women's health and anti-infectives. The company has guided for 30-35% growth in the domestic business in FY22. Growth drivers will be improved productivity for its chronic and sub-chronic area, Covid related boost and new product launches.

Export of formulations is also expected to post a robust growth on the back of strong pipeline and visible launch schedule in FY22. Business from Europe will also witness strong growth as additional capacities are created with UK MHRA approval of Baddi plant-III and reinstatement of full GMP status of Goa plant-I would boost the business. Europe business recorded strong 47% yoy rise in FY20 and 55% increase at Rs 239cr in FY21. Company has guided for around Rs 300cr revenue from Europe for FY22. Management commented that they have enough capacity and don't need to do expansion; they have guided for capex of ~Rs 80cr for FY22E. We expect regulated market business to register robust 26% CAGR over FY21-23E to Rs 631cr led by new limited competition products launches. Expertise in R&D, backward integration in select products, its own CRO set-up, partnership model in Europe and a strong customer base are some of the key positives for the company.

On Sep 15, 2020, we had initiated coverage on Indoco Remedies for the base case target of Rs 275 and bull case target of Rs 303 and bull case target got achieved on Dec 4, 2020. (https://www.hdfcsec.com/hsl.research.pdf/Initiating%20Coverage%20-%20Indoco%20Remedies%20-%2015%20Sep%202020.pdf). Indoco recorded very strong performance in FY21 mainly led by robust growth in international markets business. Company has given strong guidance for FY22 across its key markets and we have introduced FY23 estimates.

Valuation & Recommendation:

We have revised upwards revenue/EBITDA/PAT estimates by 1%/19%/14% for FY22 and introduced FY23 estimates. We estimate 20% revenue CAGR led by strong ~18% growth from domestic business and 26% CAGR from regulated markets over FY21-23E. On the back of stronger revenue growth, operating leverage would also play a part and we estimate 280bps margin expansion over the next two years. Strong revenue across geographies along with better operational performance would drive robust 49% PAT growth over the same period resulting in strong cash flows with net debt free status and sharp improvement in RoEs. Indoco's 60%+ current gross block is invested for regulated markets which is likely to witness a sharp uptick in utilisations over next 2 years. At CMP, the stock trades at ~21x FY23E earnings. Robust export revenue growth, healthy margin expansion, lower capex outlay and improvement in return ratios are key triggers. We feel investors can buy the stock in Rs 457-462 band and add more on dips at Rs 413-419 band (18.5x FY23E EPS) for base case target of Rs 506 (22.5x FY23E EPS) and bull case target price of Rs 540 (24x FY22E EPS) over the next two quarters.

Financial Summary

Particulars (Rs cr)	Q1 FY22	Q1 FY21	YoY (%)	Q4 FY21	QoQ (%)	FY19	FY20	FY21	FY22E	FY23E
Total Revenues	387	276	40.1	305	26.8	968	1,106	1,241	1,533	1,791
EBITDA	87	49	77.6	55	59.0	77	123	224	310	375
Depreciation	22	19	16.8	19	19.4	72	71	73	80	86
Other Income	1	0	200.0	2	-55.0	6	3	3	4	6
Interest Cost	4	6	-27.6	5	-8.7	21	26	22	18	14
Tax	22	7	208.6	9	151.2	-6	5	39	72	73
APAT	40	17	133.5	25	58.8	-3	24	93	145	207
EPS (Rs)						-0.3	2.6	10.1	15.7	22.5
RoE (%)						-0.4	3.6	12.9	17.4	21.1
P/E (x)						-	175.1	45.3	29.2	20.4
EV/EBITDA (x)						56.9	35.4	19.4	14.0	11.5

(Source: Company, HDFC sec)

Indoco Remedies Ltd.

Q1FY22 result update

Indoco Remedies reported strong Q1FY22 performance across key segments. Revenue/EBITDA growth of 40%/78% YoY was led by India (+54% QoQ), US (+40% QoQ) and Europe (+14% QoQ) businesses. Domestic market contributed ~62% of its revenues while exports revenue for the quarter stood at 42%. Gross margin remained flat QoQ, but EBITDA margin improved 460bps QoQ led by operating leverage. EBITDA margin expanded 110bps YoY and 30bps QoQ to 22.5% on account of lower employee expenses. PAT for the quarter came in at Rs 39.7cr, up 133% YoY, 59% QoQ.

Domestic business grew 46% YoY and 54% QoQ led by growth in anti-infective and respiratory products of 170% and 140%. It was also led by traction from Covid portfolio during the pandemic's second wave. Revenue growth for key products Karvol Plus and ATM (Azithromycin) was at 570% and 209% YoY, while Cyclopam and Febrex grew by 4% and 16%. Indoco is now the third-largest player in the Azithromycin market. The company has maintained its India revenue guidance of Rs 800-850cr in FY22E vs. Rs 619cr in FY21, led by strong pick-up in key products and new launches. Indoco is now at no.8 in the ophthalmic segment.

The company has 2,300 marketing representatives (MR) and has guided for the launch of 15-20 new products in FY22E vs. 9 in FY21. It launched two products during the quarter - Naricover Lozenges (Respiratory) and Methycal 60K, (vitamin/mineral/nutrient).

US revenues include Rs 15cr from milestone income received from Teva. Excluding milestone income, US sales growth at 16%.

Restructuring exercise for improvement in MR productivity & therapy calibration is likely to yield productive growth in Indian formulations.

Clearance from UK-MHRA & lifting of US FDA warning letters for Goa plant II and III would likely to improve operating leverage for export formulations.

Conference call highlights

- The company has 16 products in the US: four solid dosages, 10 injectable, two ophthalmic suspension. Management plans to file 5-6 products in the US in FY22.
- One ophthalmic product is planned for launch in April-2022 (three to four player competition) with estimated market size of US$ 500mn and another sustained release product launch in Nov-2022.
- Gross margin increased in Q1FY22 mainly due to product mix in Indian business

- In the next two to three years, 13 ophthalmic products are planned for approval; all pending approvals for this duration have an estimated market size of ~US$ 4.6bn.
- From Teva's legacy portfolio, two products will be launched in Nov/Dec-2021 and another two in April, 2022
- Management is confident of improvement in EBITDA margin (earlier guidance of ~20% for FY22)
- Capex during the quarter was at Rs 21cr; it has guided for a capex of ~Rs 80cr in FY22
- Around 60% of promotional cost have come back and travel cost is also expected to increase soon
- R&D expenses have increased and will continue for the next two to three quarters due to work on product pipeline in US & EU (complex injectable, ophthalmic suspension, sustained release)
- Company has appointed a chief marketing officer in India to drive growth and increase market share.
- Indoco highlighted that the profit share for Brinzolamide from its foreign partner Teva would be realized from Q2 FY22E onwards. The company guided for the launch of one more ophthalmic product in the US in Apr/May-2022 (post patent expiry) with a market size of US$ 400mn and will have limited competition.
- Europe revenue increased 65% YoY led by increased demand for analgesics in the UK and tender supplies in Germany. Indoco is a contract manufacturer for paracetamol in Europe and has increased the price for its customers due to higher API prices.
- Indoco has 16 products in the US market, including 4 solid dosages, 10 injectables and 2 ophthalmic suspensions; 25 products are in pipeline - 13 of these are ophthalmic solutions and 6 are injectables.
- Management guided revenue of Rs 250cr for FY22E (vs. Rs 148cr in FY21) led by 4-5 launches. For Goa plant - I, a request for the inspection of the site was submitted to the US FDA in Sep-2020 and the company is awaiting for inspection.
- Emerging Markets revenues grew 30% YoY for the quarter. Company has guided for revenue of Rs 115-120cr in FY22.
- API business declined 51% YoY in the quarter due to higher captive consumption. Patalganga facility is operating at around 65% utilisation levels.
- Indoco is ranked 29th (21st by prescription) by value with a market share of 0.66%.

Regulated markets to see strong growth post regulatory resolution

Indoco Remedies (Indoco) has seen a sharp turnaround in its regulated markets business post the resolution of compliance issues by USFDA & EU authorities. Both these markets were hit in FY18/19 due to compliance issues at plants. US revenues were hit in

FY18 after the US FDA inspection in March'17 at its Goa Unit-II & III facilities (Injectables, Ophthalmic & Solid Orals) resulted in a warning letter.

The growth trajectory is likely to sustain as new product filings that were stuck due to these issues will now get unfolded. Also in Jan'18, the Goa Unit-I facility (Orals, Ointments and Capsules) was inspected for which the company had received 8 observations. The site was later classified as OAI (official action indicated). Re-inspection of the site took place in Jan'19 and the US FDA retained the OAI status which eventually led to a warning letter in Jul'19. Post the resolution of large part of these issues, its regulatory markets business had registered a growth of 58% CAGR over FY19-21.

Indoco targets to file 5-6 ANDAs for FY22. It spends 4-5% of revenue in R&D which is likely to continue in the medium term. Indoco has 16 products in the US which includes 4 solid dosages, 10 injectables and 2 ophthalmic suspension. It has 25 products which are in pipeline - 13 of these are ophthalmic solutions and 6 are injectables. With number of ANDAs and Dossiers awaiting approval, the future for the regulated markets (mainly Europe and US) looks optimistic over the next two years. Indoco has supply agreements with companies like Watson, Aspen and DSM to supply formulations to advanced and emerging markets.

In Goa Plant-I, remedial procedure with US consultants is ongoing to resolve the concerns raised in the warning letter. The company has submitted all updates on its remediation progress around Unit-I in Goa (OAI – Official Action Indicated - status) and is awaiting an inspection (virtual/onsite). Europe business continued to remain firm in the last two years and the company is looking to grow further by new dossier filings.

After three years of continuous decline in US revenues, the company posted robust growth in US business. As the WL has been classified as VAI (Voluntary Action Indicated) and now the products are expected to get approvals as it is visible in FY21. We expect regulated markets to see 26% CAGR in revenues over FY21-23E. US business should see strong growth given a low revenues base due to regulatory issues.

Europe continues to be a major contributor of sales in the International Business. During FY21, sales from Europe region registered 55.5% growth at Rs 239cr. UK and Germany remain the top revenue generators for the region, followed by Spain and Eastern Europe. Management has guided for strong growth from Europe business for the next two years.

Emerging Markets and API Business

Emerging markets includes mainly Africa, Asia, LatAm and others. Emerging markets revenues grew 17.5% yoy at Rs 92.5cr in FY21. In South Africa, the company has a tie up with Aspen.

Company has expanded capacity by commissioning of new API manufacturing facility at Patalganga. US FDA inspections were successfully completed at Indoco's API manufacturing facilities at Patalganga and Rabale, Navi Mumbai. This has helped the company to source key raw materials and in margin improvement. With a good product mix of APIs in ophthalmics, anti-diabetic, antigout and other therapeutic categories backed by DMFs and Certificates of Suitability (CEP), the API division is expected to deliver healthy double digit growth over the next two years. Revenues from API business grew 9% at Rs 94cr in FY21.

Domestic formulation business

Through its nine marketing divisions viz. Indoco, Spade, Warren NxGen, Warren ACE, Warren Excel and Vision, Indoco Focus, Indoco CND, Spera and Institution the company serves a range of doctor specialties. Indoco has 2,300 Medical Representatives (MRs), 50% marketing acute products, the rest chronic and sub-chronic ones. Company has 27 brands, which ranks amongst top-5 in its respective therapeutic segments. The key brands in India include Cyclopam (gastro), Febrex plus (respiratory), Cital (Urology), Homide (ophthalmology), Carmicide (gastro), Oxipod and ATM (anti-infectives), Sensodent, Sensoform and Rexidin (stomatology).

Company derives 75-80% of its domestic revenues from acute while the balance from chronic and sub-chronic areas. The key focused therapeutic areas in India are stomatology (~21% of domestic revenues), respiratory (15%), Gastro-Intestinal (14%), anti-infectives (13%) and Vitamins (7%). The company has a predominant presence in South (34%) and West (29%), followed by East (20%) and North (17%).

Domestic formulation revenue split

(Rs cr)	FY19	FY20	FY21
Stomatology	112	127	132
Gastro-Intestinal	86	97	87
Anti-Infectives	89	105	82
Respiratory	97	114	95
Vitamins (VMN)	48	49	45
Gynaecology	33	38	34
Ophthalmology	37	40	30
Anti-diabetic	25	28	28
Pain	34	33	25
Dermatology	28	30	28

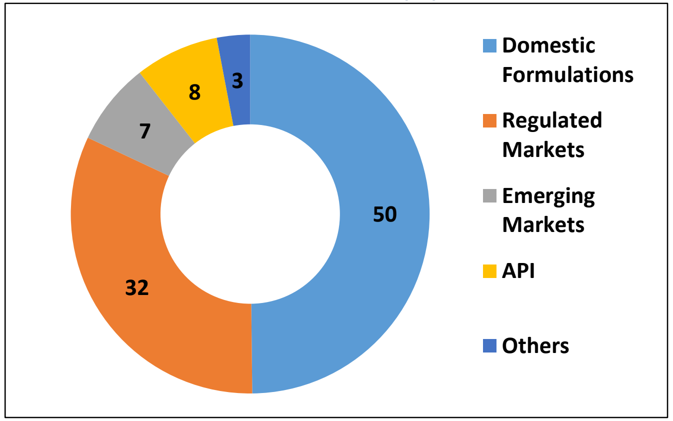
Source: Company, HDFC sec Research

Key Concerns

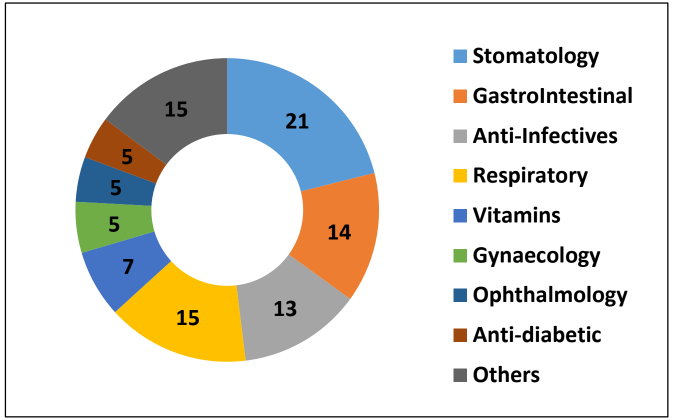
- Any adverse regulatory action from US/EU authorities upon inspection of its dedicated facilities
- We have projected robust growth from regulated markets given strong guidance from management; lower than estimated growth would lead to pressure in profitability
- Adverse currency movement may impact its performance
- Lower than expected growth in domestic market would hamper overall profitability
- Addition of drugs in the National List of Essential Medicines (NLEM) could hurt the domestic business.
- Indoco has high concentration of acute therapies in India and one of the lowest MR productivity. Low presence in chronic could lead to lower growth in future.

Indoco Remedies Ltd.

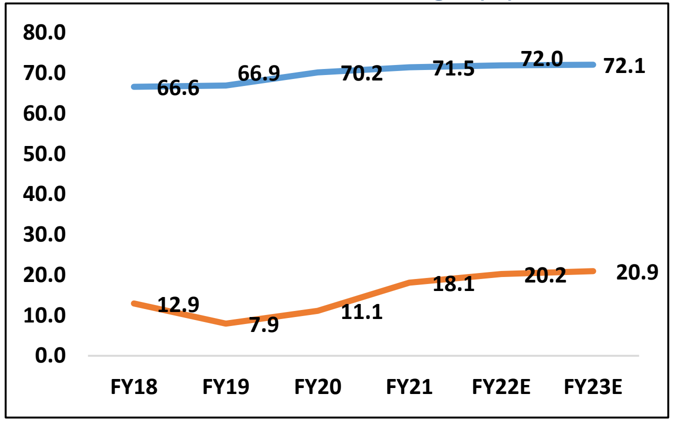
Revenue Mix (%)



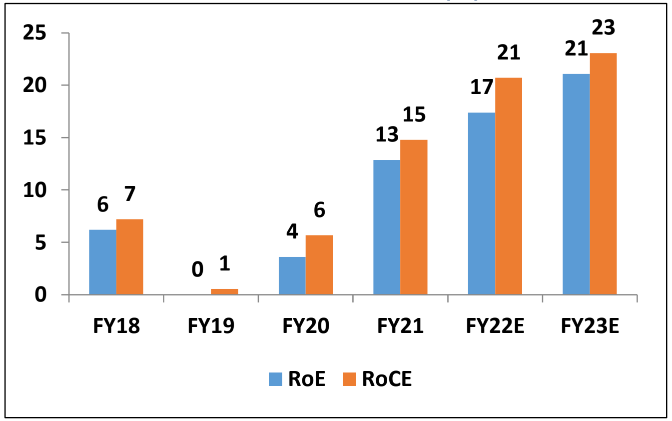
Domestic revenue split (%)



Gross and EBITDA margin (%)



Return Ratios Trend (%)



Source: Company, HDFC sec Research

RETAIL RESEARCH

Indoco Remedies Ltd.

Financials (Consolidated)

Income Statement

(Rs Cr)	FY18	FY19	FY20	FY21	FY22E	FY23E
Total Revenue	**1042**	**968**	**1106**	**1241**	**1533**	**1791**
Growth (%)	-3.1	-7.1	14.2	12.3	23.5	16.8
Operating Expenses	907	892	983	1017	1223	1416
EBITDA	**135**	**77**	**123**	**224**	**310**	**375**
Growth (%)	-14	-43.2	60.8	82.4	38.2	20.8
EBITDA Margin (%)	12.9	7.9	11.1	18.1	20.2	20.9
Depreciation	68	72	71	73	80	86
EBIT	67	5	52	151	230	289
Other Income	5	6	3	3	4	6
Interest expenses	24	21	26	22	18	14
PBT	48	-9	29	132	216	281
Tax	7	-6	5	39	72	74
RPAT	**41**	**-3**	**24**	**93**	**145**	**207**
Growth (%)	-46.6	-107.3	-903.2	286.6	55.1	43.3
EPS	4.5	-0.3	2.6	10.1	15.7	22.5

Balance Sheet

As at March	FY18	FY19	FY20	FY21	FY22E	FY23E
SOURCE OF FUNDS						
Share Capital	18.4	18.4	18.4	18.4	18.4	18.4
Reserves	657	642	661	751	875	1054
Shareholders' Funds	**675**	**661**	**679**	**769**	**893**	**1072**
Long Term Debt	123	129	97	97	72	43
Net Deferred Taxes	-35	-45	-45	-26	-26	-26
Long Term Provisions & Others	22	23	36	42	49	57
Total Source of Funds	**786**	**768**	**767**	**882**	**988**	**1147**
APPLICATION OF FUNDS						
Net Block (incl. CWIP)	517	558	550	554	567	564
Intangible Assets	107	95	91	85	82	78
Long Term Loans & Advances	40	22	23	28	33	39
Total Non-Current Assets	**664**	**675**	**665**	**666**	**681**	**681**
Current Investments	0	0	0	0	13	39
Inventories	193	183	208	238	298	352
Trade Receivables	210	196	210	234	306	351
Cash & Equivalents	12	37	38	14	41	114
Other Current Assets	124	122	106	135	144	149
Total Current Assets	**541**	**538**	**564**	**623**	**805**	**1008**
Short-Term Borrowings	110	113	106	116	98	79
Trade Payables	150	171	166	113	211	262
Other Current Liab & Provisions	120	117	136	131	137	144
Short-Term Provisions	38	44	52	47	52	57
Total Current Liabilities	**420**	**446**	**461**	**407**	**498**	**542**
Net Current Assets	122	92	103	216	307	466
Total Application of Funds	**786**	**768**	**767**	**882**	**988**	**1147**

Indoco Remedies Ltd.

Cash Flow Statement

(Rs Cr)	FY18	FY19	FY20	FY21	FY22E	FY23E
Reported PBT	48	-9	29	132	216	281
Non-operating & EO items	-5	-6	-3	-3	-4	-6
Interest Expenses	24	21	26	22	18	14
Depreciation	68	72	71	73	80	86
Working Capital Change	-2	59	4	-123	-64	-86
Tax Paid	-10	-4	-4	-20	-72	-74
OPERATING CASH FLOW (a)	**123**	**132**	**123**	**82**	**175**	**215**
Capex	-145	-97	-59	-77	-90	-80
Free Cash Flow	-22	37	49	-19	85	135
Investments	5	-13	1	7	-5	-5
Non-operating income	5	6	3	3	4	6
INVESTING CASH FLOW (b)	**-135**	**-104**	**-56**	**-67**	**-91**	**-79**
Debt Issuance / (Repaid)	2	16	-34	-5	-18	-21
Interest Expenses	-24	-21	-26	-22	-18	-14
FCFE	-55	23	4	-36	48	100
Share Capital Issuance	0	0	0	0	0	0
Dividend	-18	-11	-3	-3	-20	-28
FINANCING CASH FLOW (c)	**-39**	**-16**	**-64**	**-30**	**-57**	**-63**
NET CASH FLOW (a+b+c)	-51	12	3	-15	27	73

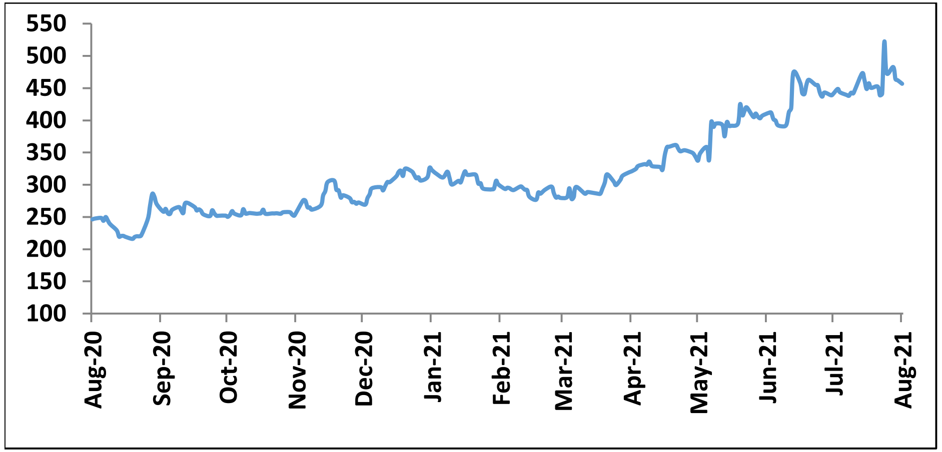
Key Ratios

	FY18	FY19	FY20	FY21	FY22E	FY23E
EBITDA Margin	12.9	7.9	11.1	18.1	20.2	20.9
EBIT Margin	6.4	0.5	4.7	12.2	15	16.1
APAT Margin	3.9	-0.3	2.2	7.5	9.4	11.6
RoE	6.2	-0.4	3.6	12.9	17.4	21.1
RoCE	7.2	0.5	5.7	14.8	20.7	23.1
Solvency Ratio						
Net Debt/EBITDA (x)	1.6	2.7	1.3	0.9	0.3	-0.1
D/E	0.3	0.4	0.3	0.3	0.2	0.1
Net D/E	0	0	0	0	0	0
PER SHARE DATA						
EPS	4.5	-0.3	2.6	10.1	15.7	22.5
CEPS	11.8	7.4	10.3	18	24.3	31.8
BV	73.2	71.7	73.7	83.5	96.9	116.4
Dividend	1	0.3	0.3	1.5	2	2.8
Turnover Ratios (days)						
Debtor days	73	74	69	69	73	72
Inventory days	67	71	65	70	71	72
Creditors days	102	125	104	70	97	103
VALUATION						
P/E	102.6	-	175.1	45.3	29.2	20.4
P/BV	6.3	6.4	6.2	5.5	4.7	3.9
EV/EBITDA	32.3	56.9	35.4	19.4	14	11.5
EV / Revenues	4.3	4.7	4.1	3.6	3	2.5
Dividend Payout	22.4	-	11.5	14.8	12.8	12.5

Source: Company, HDFC sec Research

Indoco Remedies Ltd.

Stock Price Chart



HDFC Sec Retail Research Rating Description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Blue Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

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Any holding in stock – No

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