



JOINDRE CAPITAL SERVICES LTD.

SEBI REGN NO. INH000002061 / INB 230766739 / INB 011107555

RESEARCH REPORT

22nd Nov 2017

IOL CHEMICALS AND PHARMACEUTICALS LIMITED

BSE : IOLCP

Sector: PHARMA & SPECIALITY CHEMICALS

BSE: 524164

View - BUY

CMP : Rs. 69.35

Target Price: Rs 118 (In next 12 to 18 mths)

BUSINESS BACKGROUND

IOL Chemicals and Pharmaceuticals Limited (IOLCP) a one of the largest players in Specialty Organic Chemicals and Bulk Drugs (API's), headquartered in Ludhiana (Punjab). IOLCP operates in two business segments, Specialty organic chemicals and Bulk Drugs with its manufacturing facility at Barnala (Punjab).

IOLCP has its footprints in 56 countries and regularly supplying its high quality products to major pharmaceutical players like Sanofi Aventis (India and Hungary), Aristo Pharmaceuticals, Prati Donaduzzi E Cia Ltda (Brazil), Cipla, BASF (USA), UPL, Abbot India and ZIBO XINUA-Perrigo Pharmaceutical (China). With its backward integrated USFDA accredited Ibuprofen plant, IOLCP has emerged as favorable supplier abroad.

INVESTMENT HIGHLIGHTS

Healthy Turnaround in operations witnessed in H1FY18 –

IOLCPL reported healthy Q2FY18 numbers with Topline placed at Rs 218 crs from Rs 187 crs – up by 17% YoY, a EBIDTA of Rs 29.47 crs from Rs 25.18 crs in Q2 last year – up by 17% YoY. The PAT for Q2FY18 stood at Rs 4.43 crs as compared to Rs 0.95 crs in Q2 last year – up by 366% YoY. For H1 of FY18, sales have totalled Rs 450.76 crs, a EBIDTA of Rs 57 crs and a PAT of Rs 7.41 crs – up by 346% YoY. EBIDTA margins in Q2FY18 have improved to 13.51% from 13.46% in Q2 of last year.

For FY17, IOLCPL reported a Topline of Rs 710.65 crs from Rs 580.41 crs last year, a EBIDTA of Rs 102 crs from Rs 51 crs last year followed by a PAT of Rs 4.23 crs from a net loss of Rs 40 crs last year.

IOLCPL Product mix includes Pharma and Speciality Chemicals –

IOLCPL has 2 business divisions which include the Speciality Chemicals and API Pharma unit. Within the Pharma product basket, IOLCPL has the largest Ibuprofen Plant by capacity which is approved by USFDA and EDQM with a 17% global share. IOLCPL has a integrated plant with backward integration consisting of about 50% raw material cost having a installed capacity of 7200 TPA. In FY17, the Pharma business accounted for 55% of total revenues totaling Rs 411 crs with Ibuprofen accounting for 80% of the Pharma sales.

Also IOLCPL makes other pharma products like Lamotrigene, Metformin HCl, Fenopfibrate and Clopidogrel Bisulphate.

Within the pharma basket, IOLCP has well established customers like Sanofi Aventis, Abbott, Cadilla, Indoco Remedies, Granules, Aristo Pharma, Tabuk, Alkem Labs, Kern Pharma and Cipla etc.

KEY DATA

FACE VALUE	Rs	10.00
DIVD YIELD %		NA
52 WK HI/LOW		104/42
NSE CODE		IOLCP
BSE CODE		524164
MARKET CAP	RS	389 CRS

SHAREHOLDING PATTERN

PROMOTERS	-	41%
BANKS, MFs & DIs	-	%
FIs	-	9%
PUBLIC	-	50%

KEY FUNDAMENTALS

YE	FY18	FY19	FY20
Rev Gr%	26	22	18
EBIDTA Gr%	20	29	17
PAT Gr%	301	194	30
EPS Gr%	301	194	30
EPS (Rs)	3	8.90	11.64
ROE %	9	22	24
ROCE %	12	15	16
P/E (x)	23	8	6



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IOLCPL also makes speciality chemicals which account for 45% of its Topline –

Within the speciality chemicals product basket, IOLCPL makes speciality chemicals like Ethyl Acetate 87000 TPA, Iso Butyl Benzene (IBB) 9000 TPA, MCA 7200 TPA and Acetyl Chloride 5200 TPA.

IOLCPL has India's largest Ethyl Acetate plant at single location and uses the first continuous dual technology (green chemistry) plant for MCA and Acetyl Chloride. The company is also the second largest manufacturer for Iso Butyl Benzene (IBB) in India with a 30% global share.

Ethyl Acetate is having varied uses in different industries like pharmaceuticals, flexible packaging and printing ink manufacturing, paints and adhesives etc. IOLCPL's key markets in chemicals are African countries, Middle East, SAARC Countries and Russia. Since inception, IOLCPL has been gradually enhancing its manufacturing capacities. Moreover, other chemicals produced by IOLCPL such as Iso Butyl Benzene (IBB), Mono Chloro Acetic Acid (MCA) and Acetyl Chloride are used in manufacturing of Ibuprofen.

IBB, MCA and Acetyl Chloride are key starting materials for Ibuprofen where IOLCPL is a dominant player and is forward integrated with Ibuprofen plant. These chemicals are also directly or indirectly used in various industries viz. Pharmaceuticals, Dye, paints, flexible packaging, Ink, Drilling, etc

In FY17, the Speciality chemicals accounted for Rs 334 crs and constituted around 45% of the total topline of FY17 as compared to Rs 296 crs last year from 51% of total topline last year.

Within the speciality chemicals product basket, IOLCPL has well established customers like AkzoNobel, BASF, Sun Pharma, ITC, Strides Shashun, Granules, DIC, Nectar Life, UPL, Uflex, SinoChem Pharma etc.

IOLCPL has established itself as largest producer of Ibuprofen in India and second largest in world. It is the only company in world with backward integration facility for Ibuprofen. In Iso Butyl Benzene also niche segment, IOLCPL is the second largest producer in world.

Moreover, IOLCPL has also received the European Directorate for Quality of Medicine and Healthcare (EDQM) – Certificate of Suitability (COS) and ANVISA certification from Govt. of Brazil. This enables the company to directly enter into European and Brazil market. IOLCPL is recognized as "**TRADING HOUSE**" from Ministry of Commerce and Industry, Government of India. Export sales of the company have a niche market for its products in overseas markets and accounted for Rs 196 crs in FY17 from Rs 132 crs last year showing a growth of 48% YoY and is presently selling into around 56 countries.

IOLCPL enjoys the following certifications to cater to the Export Markets –

USFDA Certification Year 2015, **EUGMP** Certification Year 2013.

ANVISA certification Year 2012, Certificate of Suitability from EDQM for **IBUPROFEN**, CEP No. 316-2008

Certificate of Suitability from EDQM for **LAMOTRIGINE**, CEP No. 066-2013

Certificate of Suitability from EDQM for **METFORMIN HYDROCHLORIDE**, CEP No. 188-2013

Certificate of Pharmaceuticals Product(COPP)-WHO-GMP for IBUPROFEN.



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Ministry of Health (MOH) approval by Japan/Philippines/ Iran / Ukraine.

Kosher & Halal Certificate for all finished products

Pre-Reach certification for all chemical products and Intermediates.

ISO9001:2008, 14001:2004 & 18001:2007

Certificate of Star Trading House Status for Export, from Govt. of India

Pharma Industry Overview & Ibuprofen Demand Outlook –

This Indian Pharma Industry currently tops the chart with wide range of capabilities in manufacturing of complex drugs & due to generic business manufacturing hub. Indian pharmaceutical industry is a highly knowledge based industry and is ranked world class in terms of technology, quality, purity, stability and international safety, health and environmental protection in production and supply of bulk drugs. Pharma sector plays a major role in the Indian economy as it caters to around 70% of the country's total medicines demand including drug intermediates, bulk drugs, tablets and capsules. Currently this industry is estimated to be worth \$4.5 billion & growing about 8-9% p.a.

During 2010-2020, patent for drugs worth around \$170 billion is expected to go off leading to a huge surge in generic products, which would also provide remarkable opportunities to the Indian companies. Therefore, Indian generic drugs segment is likely to grow at robust pace in the near future.

The government of India has aggressively granted 100% FDI in drug & Pharma sector to establish various Pharma SEZs across the country. Exports have been the cornerstone of growth for Indian pharmaceutical industry, with overseas pharmaceuticals market particularly developed markets offering strong growth opportunities to domestic companies. Indian pharmaceutical industry is an important contributor to the foreign reserve of the country with around 50% of industry revenue coming from overseas market.

The US market accounts for highest revenue for the Indian pharma industry as the country has the largest number of USFDAs approved plants for generic manufacture.

The Ibuprofen demand worldwide has grown from 30330 TPA in FY12 to 33211 TPA in FY14 and further to 36800 TPA in FY17 as against installed capacity worldwide is 31350 TPA as on FY17. We expect the demand for Ibuprofen to grow further to 37770 TPA in FY18E and 40000 TPA in FY19E creating shortage of 4000 TPA in FY18E & 4800 TPA in FY19E. To cater to this growing demand IOLCPL is geared up for further expansion by adding additional capacities. Also offlate in the last 6 months Ibuprofen prices have increased by 25-40% by around Rs 65-75 per kg. The company expects that it is confident of a average 25% increase in coming year even after prices cool off but these prices will still be higher than last year enabling higher EBIDTA margins in FY18 and some improvement has been visible in H1 of FY18 already.



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Chemical Industry Overview –

India's chemical industry is one of the largest and most diversified industries in the country. It consists of several small industries that cover hundreds of segments. Chemicals are generally used to make a wide variety of consumer goods and are also used in agriculture, manufacturing, construction, and service industries.

The chemical industry itself consumes 26% of its own output. Major industrial customers include rubber and plastic products, textiles, apparel, petroleum refining, pulp and paper, and primary metals. With the chemical industry contributing indirectly to almost every sector of the economy, it plays a vital role in a country's economic growth.

The domestic chemical industry contributes 3-4% in India's GDP while India accounts for 8.3% of the Asia-Pacific chemicals market's value. The growth of chemicals is projected at 10% in 12th five year plan. India emerges as one of the focus destinations for chemical companies worldwide. The current Indian chemical industry size is \$108 billion.

India is now gaining significant share in the Global Pigments & Dyestuffs markets –

The Indian dyestuffs and pigments industry has transformed from being import dependent to an export driven industry. Given the stringent measures in majority of the developed economies, companies are sourcing the dyes intermediates and pigments from cost-effective markets (developing economies). Exports from India have grown at double digit over the last few years.

Large manufacturers of dye intermediates in China were asked to shut their operations due to non-compliance of environmental norms. It is now mandatory for chemical companies in China to first focus on effluent treatment mechanisms before starting business (production activity), which has substantially increased the manufacturing cost over there.

Considering the strict norms and margin erosion of chemical companies globally, and a sharp rise in labour costs as well as declining state support has also led to diminishing cost advantage of Chinese players thereby benefiting Indian players at large.

Also with plant shutdowns in China, global customers are looking at diversifying their procurement base and increasingly targeting India as the next alternate source thereby benefiting Indian dye intermediates and dye stuff industry at large.

The global market for pigment is expected to grow at an estimated CAGR of 4.5% between 2013 and 2020 (\$14.7 billion by 2018). There is a growing traction in buying from organised players following downstream customers demanding higher product quality and environment integrity.

IOLCPL is attractively placed as it is one of key suppliers of speciality chemical products which find extensive uses in a wide product range (printing, paints, plastics, automobile coatings and textiles) and expects to carve out a larger wallet share going ahead.



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Projects planned by IOLCPL in the current year and going ahead –

During the year under review, IOLCPL has successfully completed commissioning of extra capacity for its chemical products like Lamotrigene, Metformin HCl, Fenofibrate and Clopidogrel Bisulphate which was done at a cost of Rs 16.48 crs and was fully financed internally.

Also IOLCPL is planning to set up a green field facility of producing a anti diabetic product namely Metformin which will done at its existing facility at a cost of Rs 10 crs which will also be funded fully by internal accruals.

Further the IOLCPL management has also stated that it intends to further ramp up Ibuprofen capacity from 7200 TPA to 12000 TPA over the next 2 years as well as increasing the capacity of other ancillary chemical products like Ethyl Acetate, MCA and Acetyl Chloride. The total cost is estimated at Rs 200 crs which will be funded by a mix of internal accruals, debt and equity. However the management has also made it clear to us that it will be not be in a hurry to start capex immediately and will look at incremental capex as stated above only after it gets a optimal return on new invested capital and hence these plans as of now are only on the drawing board table.

Solid financial performance - topline growth and margin expansion –

We estimate IOLCPL's earnings to witness a CAGR of 70-80% plus over FY17-20E.

Over the years, the company has improved its operational performance significantly with its operating margins having remained in a range between 9 to 14% since last 2 years. Also it has been able to increase the return on equity to 2% and a ROCE of 10% as on FY17 and showed a strong turnaround in operations as compared to net losses in the last two years between FY15 to FY16. A key negative for IOLCPL at this point of time is the high leverage as on FY17 which is placed at 2.29:1x as on FY17. However going ahead by FY20E we expect the leverage to come down to 1.30:1.

However from coming year that is FY18 onwards we expect operating profitability to improve significantly on the back of higher Ibuprofen prices and better operating leverage kicking in hence we expect the leverage to reduce to around 1.30:1 levels over the next 2 years. In fact we expect that by FY20E the ROE to touch 24% from 2% currently while ROCE is also expected to increase to 16% from 10% in FY17.



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Business Outlook & Stock Valuation –

On a rough cut basis, in FY18, Topline is expected to touch Rs 900 crs.

On the bottomline level we expect the company to record a PAT of Rs 17 crs in FY18E. Thus on a conservative basis, IOLCPL should record a EPS of Rs 3 for FY18E. For FY19E and FY20E our expectation is that earnings traction for IOLCPL would continue to remain strong wherein we expect a EPS of Rs 9 and Rs 11.64 respectively.

The Ibuprofen demand worldwide has grown from 30330 TPA in FY12 to 33211 TPA in FY14 and further to 36800 TPA in FY17 as against installed capacity worldwide is 31350 TPA as on FY17. We expect the demand for Inuprofen to grow further to 37770 TPA in FY18E and 40000 TPA in FY19E creating shortage of 4000 TPA in FY18E & 4800 TPA in FY19E. To cater to this growing demand IOLCP is geared up for further expansion by adding additional capacities. Also offlate in the last 6 months Ibuprofen prices have increased by 25-40% by around Rs 65-75 per kg.

The company expects that it is confident of a average 25% increase in coming year even after prices cool off but these prices will still be higher than last year enabling higher EBIDTA margins in FY18 and some improvement has been visible in H1 of FY18 already.

In fact we believe that IOLCPL is clearly in a strong turnaround mode and we expect an acceleration in EBIDTA margins in FY19 as the current de bottlenecking and capacity utilization would improve the companys financials going ahead. Also in terms of EPS growth we expect a strong trajectory of over 70-80% in the next 2 years as operating profitability is likely to get better as long as product prices remain high and capacity utilization also improves

Hence we believe that at the current price of 69.5 the IOLCPL stock looks undervalued at a PE of 8x and 6x based of FY19E and FY20E and should be purchased at the current price for a price target of around Rs 118 over the next 12 to 18 months.

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FINANCIALS

For the Year Ended March RsCr	FY16A	FY17A	FY18E	FY19E	FY20E
Net Sales	580.41	710.65	900.1	1100.1	1300.1
EBIDTA	51.36	101.64	122.14	158.1	185.10
EBIDTA %	8.85	14.30	13.57	14.37	14.24
Interest	61.46	67.41	65.00	60.00	54.00
Depreciation	29.68	29.94	30.00	32.00	34.00
Non Operational Other Income	1.23	1.18	1.00	1.00	1.00
Profit Before Tax	-38.55	5.47	28.14	67.1	98.10
Profit After Tax	-40.02	4.23	17.00	50.00	65.40
Diluted EPS (Rs)	-	0.75	3.02	8.90	11.64
Equity Capital	56.2	56.2	56.2	56.2	56.2
Reserves	128.92	133.15	150.15	192.15	247.55
Borrowings	438.00	427.00	420	390.00	360.00
GrossBlock	402.31	395.25	415.25	465.25	515.25
Investments	0.04	0.04	0.04	0.04	0.04

Source Company our Estimates

KEY CONCERNS

Currently there is no further capacity addition by peers; But Capacity addition by peers in future may hamper the demand/supply curve of products.

IOLCPL is already highly leveraged, in case debt further goes up and operating margins come under pressure then the company could face a pressure on its bottomline growth



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