

Cipla

Better days ahead

**UPGRADE TO
OUTPERFORMER**

14 August 2014

BSE Sensex: 26103

Sector: Pharmaceuticals

Stock data

CMP (Rs)	449
Mkt Cap (Rsbn/USDbn)	360 / 5.9
Target Price (Rs)	485
Change in TP (%)	+29
Potential from CMP (%)	+8
Earnings change (%)	
FY15E	↔
FY16E	+1
Bloomberg code	CIPLA IN
1-yr high/low (Rs)	463/367
6-mth avg. daily volumes (m)	1.79
6-mth avg. daily traded value (Rsm/US\$m)	720.3 / 11.76
Shares outstanding (m)	803.9
Free float (%)	63.2
Promoter holding (%)	36.8

Q1FY15 result highlights

- Consolidated revenues grew 14% yoy to Rs26.5bn (est. Rs28.7bn). Exports, including Medpro, grew 13% yoy to Rs12.2bn (est., Rs14.4bn). Exports growth was hit by ongoing business rationalization as also higher Dymista sales in Q1FY14. Domestic sales grew strongly by 17% to Rs12.9bn.
- EBIDTA margin came in at 17.7% (+460bp qoq; est. of 17.3%), with stabilization of overheads along with increasing revenue contribution from India business. Reported EBIDTA was lower, at Rs4.7bn, vs. our estimate of Rs4.96bn.
- Other operating income was higher, at Rs728m. Cipla booked forex gain of Rs250m, which was negated by higher depreciation and tax expenses. So, PAT came in at Rs 2.95bn, vs. our estimate of Rs3.31bn.

Key positives: Strong API sales; higher other operating income and forex gain.

Key negatives: Lower margins and ex-Medpro sales.

Impact on financials: No significant change to our FY15/ 16E estimates.

Valuations & view

Given a muted 9% PAT CAGR over FY10-14 as it underwent a strategic transformation and limited US sales contribution, Cipla significantly underperformed the BSE healthcare index (92% over past 4 years). After a prolonged investment phase, we believe Cipla is likely nearing an inflection point in terms of accelerated earnings growth catalyzed by multiple high-value potential launches in the US over the next few quarters (gBaraclade, gTobi, gXoponex, etc). This will be supported by continued strong performance in India business (~40% of sales) and strong cash flow generation (~Rs15bn operating cash flow in FY14). Upgrade to Outperformer with a TP of Rs485. Any potential price control action by NPPA impacting Cipla's domestic business profitability is a key risk.

Price performance – relative and absolute



(%)	3-mth	6-mth	1-yr
Cipla	13.7	20.2	6.7
BSE Sensex	9.6	28.2	34.8

Key financials (quarterly)

(Rs m)	Q1FY14	Q4FY14	Q1FY15	% ch qoq	% ch yoy	% var from est
Net sales	23,312	24,293	26,472	9.0	13.6	(7.6)
EBITDA	5,095	3,190	4,690	47.0	(7.9)	(5.4)
OPM (%)	21.9	13.1	17.7	4.6	(4.1)	0.4
Other inc.	2,489	1,678	1,132	(32.5)	(54.5)	25.8
Interest	396	341	333	(2.3)	(15.8)	(4.8)
Dep. & Amort.	850	1,050	1,254	19.4	47.5	16.7
PBT	6,337	3,477	4,235	21.8	(33.2)	(4.5)
PAT	4,854	2,607	2,946	13.0	(39.3)	(10.9)
Reported PAT	4,854	2,607	2,946	13.0	(39.3)	(10.9)
EPS (Rs)	6.0	3.2	3.7	13.0	(39.3)	(10.9)

Nitin Agarwal

nitin.agarwal@idfc.com
91-22-6622 2568

Param Desai

param.desai@idfc.com
91-22-6622 2579

For Private Circulation only.

Important disclosures appear at the back of this report*

Consolidated quarterly results: Detailed

(Rs m)	Q1FY14	Q2FY14	Q3FY14	Q4FY14	Q1FY15	FY14	FY15E	Comments
Net Sales	23,312	24,632	25,526	24,293	26,472	101,004	117,469	Lower export revenues
Expenses								
Cost of sales	9,181	9,466	9,991	10,035	10,252	41,394	44,490	258bps down qoq
SG&A expenses	9,036	10,017	11,144	11,067	11,530	38,279	48,449	Below estimates led by lower SG&A cost
Total Expenses	18,218	19,482	21,135	21,102	21,782	79,673	92,939	
EBITDA	5,095	5,150	4,391	3,190	4,690	21,331	24,530	Below estimates
OPM (%)	21.9	20.9	17.2	13.1	17.7	21.1	20.9	We saw 17.3%
Other Income	2,489	1,248	805	1,678	1,132	2,371	1,000	Includes forex gain of Rs250m and other operating income of Rs728m
Interest	396	450	333	341	333	1,457	1,513	
Depreciation	850	914	912	1,050	1,254	3,726	5,277	Above estimates
PBT	6,337	5,034	3,952	3,477	4,235	18,518	18,741	
Current Tax	1,536	1,358	987	753	1,019	4,634	4,835	
Deferred tax						-	-	
Tax Rate (%)	24.2	27.0	25.0	21.7	24.1	25.0	25.8	We saw 22%
Minority interest	52	(96)	(122)	(117)	(270)	-	-	
PAT	4,854	3,581	2,843	2,607	2,946	13,884	13,906	Below estimates
Extraordinary expenses	-	-	-	-	-			
Extraordinary Income								
Reported PAT	4,854	3,581	2,843	2,607	2,946	13,884	13,906	
% chg yoy								
Sales	20.6	13.7	25.1	22.8	13.6	22.0	16.3	
EBITDA	0.3	(21.1)	(3.1)	(25.1)	(7.9)	(1.4)	15.0	
Other Income	170.5	10.2	(13.6)	196.6	(54.5)	209.2	10.6	
Interest	1,338.9	897.1	257.6	81.6	(15.8)	329.8	3.8	
Depreciation	6.8	13.1	16.9	23.4	47.5	26.2	41.6	
PBT	22.4	(26.0)	(14.0)	(8.1)	(33.2)	(9.6)	1.2	
PAT	21.2	(26.6)	(16.1)	(5.5)	(39.3)	(8.6)	0.2	
Reported PAT	10.3	(26.6)	(16.1)	(5.5)	(39.3)	(8.6)	0.2	
EPS								
Equity	803.9	803.9	803.9	803.9	803.9	803.9	803.9	
EPS	6.0	4.5	3.5	3.2	3.7	17.3	17.3	

Source: Company, IDFC Securities Research..

Other key highlights

- Cipla reported revenues of Rs26.5bn (up 14% yoy) aided by Medpro consolidation and domestic formulations.
 - Domestic formulation business grew strongly by 17% yoy to Rs12.9bn vs. our estimates of 15%. The management attributed this to strong growth in branded formulations in key therapies such as respiratory, anti-infective and cardiology. There was a restatement of domestic business reported number of Q1FY14 from R11.32bn earlier to Rs11.02bn as part of consolidated reporting.
 - Export formulations growth was up 13% yoy (down 5% qoq), inspite of Medpro consolidation, to Rs12.2bn, vs. our estimate of Rs14.4bn. Management attributed the lower growth to continued rationalization of business and also higher Dymista sales in Q1FY14.
 - API exports decline by 5% yoy to Rs1.4bn – below our estimate of Rs1.54bn.
- Gross margins came in at 61.3%, up 240bp qoq given higher proportion of India revenues as well as continued focus on increasing higher margin business. GMs may also have been aided by weaker currency.
- EBIDTA margin came in at 17.7%, vs our estimate 17.3%, aided by stabilization of overheads (flat qoq). Though staff cost was up 12% qoq, the management indicated that costs should begin to stabilize at current levels. This combined with potential pickup in export revenues should drive operating leverage going forward. R&D cost included in other expenses was around 5% of sales, which should remain at current levels in FY15 as cited by management.
- Other operating income came in at higher at Rs 728m, vs our estimate of Rs500m. There was also forex gain of Rs250m in other income (Rs400m).
- As part of its evolving business model to establish direct front-ends in key markets, Cipla is gradually ramping up filings in the US market. For the quarter, it has filed 7 ANDAs (16 filed in FY14) on its own as well as through partnerships and is looking to file another 10-15 ANDAs in FY15. Overall, combined with the partnered ANDAs, which have been returned to Cipla, the company has 90 final approvals of which only 40 has been commercialized.
 - In Q1FY15, Cipla got 2 approvals vs 13 approvals in FY14, of which three was its own. In Dec 2013, it got approval for Xoponex nasal spray, which is the first niche ANDA approval in Cipla's own name. Cipla is the fourth generic player in the product, which has a US\$440m market size before entry of generics in March '13. However, management cited that it is yet to launch the product as it is evaluating options to launch it through its own front-end in FY15.
 - We believe that the company has partnered with Teva on gBaraclude (Teva is the potential FTF on this ~\$315m drug) which could be launched over the next few quarters once Teva receives the approval. We also believe that Cipla is partnering with Akorn on gTobi (an inhalation drug with ~\$300m sales) – Akorn recently approval for this drug and will be the second generic in the market when it launches.
 - A potential launch of these three products combined with the launch of a vast portfolio other products in H12015 when Cipla operationalize its US front-end, can lead to a dramatic growth in US sales contribution and drive significant operating leverage.
- In Q1FY15, the company incurred ~5% of sales (~Rs1.3bn) towards R&D expenses, vs 5.8% in Q4FY14 and anticipates 5-6% of sales going forward as R&D spend as it invests to create strong pipelines across geographies. In FY14, Cipla incurred 5.4% of sales towards R&D expenses.
- Cipla expects to launch Seretide (combination inhaler) in the EU market in CY15, which is equivalent to Glaxo's Advair. The market size in EU is more than US\$1bn with limited competition and recent approval for UK firm (Vectura) in Denmark increases the probability of their ability to secure approval
- For FY15, the company had maintained its mid-teen revenue growth driven by multiple factors like scale-up in the EU front-end business, approvals of a couple of niche opportunities in the US, etc. The company has guided

to 21% (flat yoy) operating margin (including other operating income), which can surprise upwards if overheads stabilize at current levels.

- The company has guided for Rs4bn capex in FY15 and another Rs1bn-1.5bn of continuing capex.
- After payment for CMP, Cipla's net debt stands at ~Rs7bn as of March 2014. Cipla had ~US\$270m of outstanding hedges as of March-2014. The company expressed confidence in returning to debt-free status in another year or so given the strong cash flow generation – the company generated ~Rs15bn of operating cash in FY14 and indicated that it generated another Rs3.86bn of operating cash in Q1FY15.
- During FY14, the company had issued ~3m of ESOPs to its senior employees. Around 1.5m shares were issued at FV of Rs2/ share and rest was issued at 50% discount to market value. Once vested, it will dilute 0.4% at current equity base. Further, Rs920m has been incurred to grant such options, which will be amortized (Rs210m amortized in FY14) over the next 3-4 years.

Income statement

Year to 31 Mar (Rs m)	FY12	FY13	FY14	FY15E	FY16E
Net sales	70,207	82,793	101,004	117,469	134,484
% growth	11.0	17.9	22.0	16.3	14.5
Operating expenses	53,828	61,167	79,673	92,939	105,337
EBITDA	16,379	21,626	21,331	24,530	29,147
% change	21.3	32.0	(1.4)	15.0	18.8
Other income	1,395	2,221	2,654	1,600	1,800
Net interest	(383)	(339)	(1,457)	(1,513)	(1,513)
Depreciation	2,912	2,952	3,726	5,277	6,010
Pre-tax profit	14,508	20,494	18,518	18,741	22,823
Deferred tax	201	-	-	-	-
Current tax	2,864	5,304	4,634	4,835	5,856
Profit after tax	11,443	15,190	13,884	13,906	16,968
Non-recurring items	-	259	-	-	-
Net profit after non-recurring items	11,443	15,448	13,884	13,906	16,968
% change	15.6	35.0	(10.1)	0.2	22.0

Balance sheet

As on 31 Mar (Rs m)	FY12	FY13	FY14	FY15E	FY16E
Paid-up capital	1,606	1,606	1,606	1,606	1,606
Reserves & surplus	74,784	88,581	98,898	110,316	124,422
Total shareholders' equity	76,389	90,187	100,999	112,417	126,524
Total current liabilities	12,214	11,093	14,208	16,219	18,129
Total debt	135	9,669	12,283	12,283	7,283
Deferred tax liabilities	2,332	2,805	3,090	3,090	3,090
Other non-current liabilities	2,432	2,824	3,424	3,701	4,020
Total liabilities	17,113	26,391	33,004	35,293	32,522
Total equity & liabilities	93,503	116,578	134,004	147,710	159,046
Net fixed assets	35,870	39,878	44,452	44,176	43,165
Total current assets	57,633	76,700	64,621	78,604	90,950
Other non-current assets	-	-	24,931	24,931	24,931
Working capital	45,419	65,608	50,413	62,385	72,821
Total assets	93,503	116,578	134,004	147,710	159,046

Cash flow statement

Year to 31 Mar (Rs m)	FY12	FY13	FY14	FY15E	FY16E
Pre-tax profit	14,508	20,494	18,518	18,741	22,823
Depreciation	2,912	2,952	3,726	5,277	6,010
Chg in Working capital	3,916	(7,027)	(2,722)	(4,288)	(5,711)
Total tax paid	(2,864)	(5,304)	(4,634)	(4,835)	(5,856)
Ext ord. Items & others	230	650	600	277	319
Operating cash Inflow	18,702	11,765	15,488	15,172	17,586
Capital expenditure	(4,987)	(6,960)	(33,232)	(5,000)	(5,000)
Free cash flow (a+b)	13,715	4,805	(17,744)	10,172	12,586
Chg in investments	(6,751)	(12,698)	17,956	(600)	(600)
Debt raised/(repaid)	(5,275)	9,535	2,614	-	(5,000)
Dividend (incl. tax)	(3,198)	(1,881)	(2,163)	(2,488)	(2,861)
Misc	1,454	765	(341)	600	600
Net chg in cash	(55)	525	322	7,684	4,725

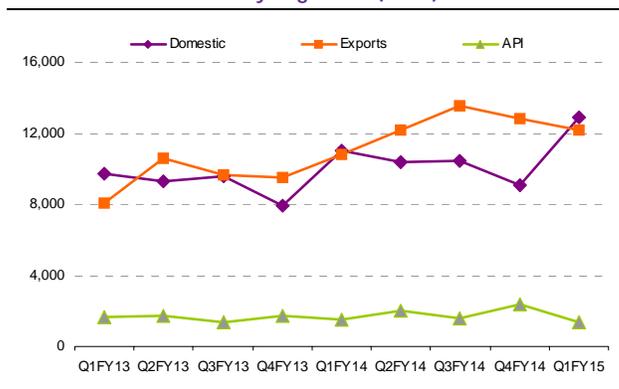
Key ratios

Year to 31 Mar	FY12	FY13	FY14	FY15E	FY16E
EBITDA margin (%)	23.3	26.1	21.1	20.9	21.7
EBIT margin (%)	19.2	22.6	17.4	16.4	17.2
PAT margin (%)	16.3	18.3	13.7	11.8	12.6
RoE (%)	16.0	18.2	14.5	13.0	14.2
RoCE (%)	17.1	20.0	15.6	15.3	17.0
Gearing (x)	(0.2)	(0.2)	0.0	(0.0)	(0.1)

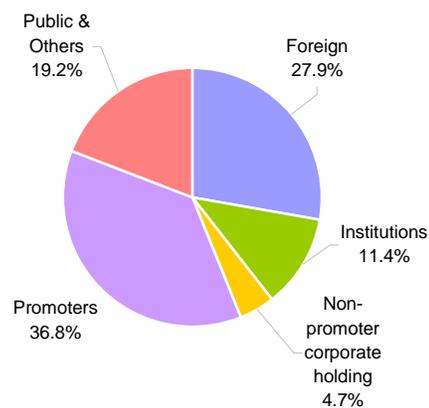
Valuations

Year to 31 Mar	FY12	FY13	FY14	FY15E	FY16E
Reported EPS (Rs)	14.2	19.2	17.3	17.3	21.1
Adj. EPS (Rs)	14.2	18.9	17.3	17.3	21.1
PE (x)	31.5	23.8	26.0	26.0	21.3
Price/ Book (x)	4.7	4.0	3.6	3.2	2.9
EV/ Net sales (x)	4.9	4.2	3.6	3.0	2.6
EV/ EBITDA (x)	21.2	15.9	17.1	14.6	11.9
EV/ CE (x)	4.3	3.3	3.0	2.7	2.5

Revenue trend across key segments (Rs m)



Shareholding pattern



As of June 2014

Analyst	Sector/Industry/Coverage	E-mail	Tel. +91-22-6622 2600
Anish Damania	Co-CEO - IDFC Securities, Head - Institutional Equities; Strategy	anish.damania@idfc.com	91-22-6622 2522
Shirish Rane	Head of Research; Construction, Power	shirish.rane@idfc.com	91-22-662 22575
Prakash Joshi	Oil & Gas, Metals, Mining	prakash.joshi@idfc.com	91-22-662 22564
Nitin Agarwal	Pharmaceuticals, Real Estate, Agri-inputs	nitin.agarwal@idfc.com	91-22-662 22568
Hitesh Shah, CFA	IT Services & Telecom	hitesh.shah@idfc.com	91-22-662 22565
Manish Chowdhary	Financials	manish.chowdhary@idfc.com	91-22-662 22563
Bhoomika Nair	Engineering, Cement, Power Equipment, Logistics	bhoomika.nair@idfc.com	91-22-662 22561
Rohit Dokania	Media & Entertainment	rohit.dokania@idfc.com	91-22-662 22567
Deepak Jain	Automobiles, Auto ancillaries	deepak.jain1@idfc.com	91-22-662 22562
Ashish Shah	Construction, Power	ashish.shah@idfc.com	91-22-662 22560
Abhishek Gupta	Telecom, IT services	abhishek.gupta@idfc.com	91-22-662 22661
Mohit Kumar, CFA	Construction, Power	mohit.kumar@idfc.com	91-22-662 22573
Param Desai	Pharmaceuticals, Real Estate, Agri-inputs	param.desai@idfc.com	91-22-662 22579
Sameer Narang	Strategy, Economy	sameer.narang@idfc.com	91-22-662 22566
Probal Sen	Oil & Gas	probal.sen@idfc.com	91-22-662 22569
Saamil Mehta	Metals, Mining	saamil.mehta@idfc.com	91-22-662 22578
Harit Kapoor	FMCG, Retail, Alcoholic Beverages	harit.kapoor@idfc.com	91-22-662 22649
Sameer Bhise	Financials	sameer.bhise@idfc.com	91-22-662 22635
Abhishek Ghosh	Engineering, Cement, Power Equipment, Logistics	abhishek.ghosh@idfc.com	91-22-662 22658
Dharmendra Sahu	Database Analyst	dharmendra.sahu@idfc.com	91-22-662 22580
Equity Sales/Dealing	Designation	E-mail	Tel. +91-22-6622 2500
Ashish Kalra	Managing Director, Sales	ashish.kalra@idfc.com	91-22-6622 2525
Rajesh Makharia	Director, Sales	rajesh.makharia@idfc.com	91-22-6622 2528
Varun Saboo	VP, Sales	varun.saboo@idfc.com	91-22-6622 2558
Arati Mishra	VP, Sales	arati.mishra@idfc.com	91-22-6622 2597
Hemal Ghia	VP, Sales	hemal.ghia@idfc.com	91-22-6622 2533
Tanvi Dixit	AVP, Sales	tanvi.dixit@idfc.com	91-22-6622 2595
Nirav Bhatt	AVP, Sales	nirav.bhatt@idfc.com	91-22-6622 2681
Chandan Asrani	Manager, Sales	chandan.asrani@idfc.com	91-22-6622 2540
Sneha Baxi	Manager, Sales	sneha.baxi@idfc.com	91-22-6622 2537
Mukesh Chaturvedi	Director, Sales trading	mukesh.chaturvedi@idfc.com	91-22-6622 2512
Viren Sompura	SVP, Sales trading	viren.sompura@idfc.com	91-22-6622 2527
Rajashekhar Hiremath	SVP, Sales trading	rajashekhar.hiremath@idfc.com	91-22-6622 2516
Alok Shyamsukha	VP, Sales trading	alok.shyamsukha@idfc.com	91-22-6622 2523
IDFC Securities US	Designation	E-mail	Telephone
Ravilochan Pola	CEO	ravilochan.pola@idfc.com	001 646 756 5865

Disclaimer

This document has been prepared by IDFC Securities Ltd (IDFC SEC). IDFC SEC and its subsidiaries and associated companies are a full-service, integrated investment banking, investment management and brokerage group. Our research analysts and sales persons provide important input into our investment banking activities.

This document does not constitute an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction.

The information contained herein is from publicly available data or other sources believed to be reliable. While we would endeavor to update the information herein on reasonable basis, the opinions and information in this report are subject to change without notice and IDFC SEC, its subsidiaries and associated companies, their directors and employees ("IDFC SEC and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent IDFC SEC and affiliates from doing so. Thus, the opinions expressed herein should be considered those of IDFC SEC as of the date on this document only. We do not make any representation either express or implied that information contained herein is accurate or complete and it should not be relied upon as such.

The information contained in this document has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. This document is prepared for assistance only and is not intended to be and is not alone to be taken as the basis for an investment decision. The investment discussed or views expressed in the document may not be suitable for all investors. Investors should make their own investigations as they deem necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved) and investment decisions based upon their own financial objectives and financial resources. Investors assume the entire risk of any use made of the information contained in the document. Investments in general involve some degree of risk, including the risk of capital loss. Past performance is not necessarily a guide to future performance and an investor may not get back the amount originally invested.

Foreign currency-denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or the price of, or income derived from, the investment. In addition, investors in securities, the values of which are influenced by foreign currencies, effectively assume currency risk.

Affiliates of IDFC SEC may have issued other reports that are inconsistent with and reach different conclusions from, the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject IDFC SEC and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to a certain category of investors. Persons in whose possession this document may come are required to inform themselves of, and to observe, such applicable restrictions.

Reports based on technical analysis centers on studying charts of a stock's price movement and trading volume, as opposed to focusing on a company's fundamentals and, as such, may not match with a report on a company's fundamentals.

IDFC SEC and affiliates, their directors, officers, and employees may from time to time have positions in, purchase or sell, or be materially interested in any of the securities mentioned or related securities. IDFC SEC and affiliates may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall IDFC SEC, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind including but not limited to any direct or consequential loss or damage, however arising, from the use of this document. Any comments or statements made herein are those of the analyst and do not necessarily reflect those of IDFC SEC and affiliates.

This document is subject to changes without prior notice and is intended only for the person or entity to which it is addressed and may contain confidential and/or privileged material and is not for any type of circulation. Any review, retransmission, or any other use is prohibited.

Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. IDFC SEC will not treat recipients as customers by virtue of their receiving this report.

IDFC Capital (USA) Inc. has reviewed the report and, to the extent that it includes present or past information, it is believed to be reliable, although its correctness cannot be assured.

The analyst certifies that all of the views expressed in this research report accurately reflect his/her personal views about any and all of the subject issuer(s) or securities. The analyst certifies that no part of her compensation was, is, or will be directly or indirectly related to the specific recommendation(s) and/or views expressed in this report.

Additional Disclosures of Interest:

1. IDFC SEC and its affiliates (i) may have received compensation from the company covered herein in the past twelve months for investment banking services; or (ii) may expect to receive or intends to seek compensation for investment-banking services from the subject company in the next three months from publication of the research report.
2. Affiliates of IDFC SEC may have managed or co-managed in the previous twelve months a private or public offering of securities for the subject company.
3. IDFC SEC and affiliates collectively do not hold more than 1% of the equity of the company that is the subject of the report as of the end of the month preceding the distribution of the research report.
4. IDFC SEC and affiliates are not acting as a market maker in the securities of the subject company.

Explanation of Ratings:

- | | | |
|-------------------|---|---|
| 1. Outperformer | : | More than 5% to Index |
| 2. Neutral | : | Within 0-5% (upside or downside) to Index |
| 3. Underperformer | : | Less than 5% to Index |

www.idfc.com

IDFC Securities
Naman Chambers, C-32, 7th floor,
G- Block, Bandra-Kurla Complex,
Bandra (East), Mumbai 400 051
INDIA

Tel: +91 22 6622 2600
Fax: +91 22 6622 2503

IDFC Capital (USA) Inc,
350 5th Avenue,
Suite 4711,
New York
NY 10118

Tel: +1 646 756 5864

Our research is also available on Bloomberg and Thomson Reuters

For any assistance in access, please contact research@idfc.com