

BSE SENSEX	S&P CNX
25,305	7,749
Bloomberg	CIPLA IN
Equity Shares (m)	803.4
M.Cap. (INR b)/(USD b)	397.7/5.9
52-Week Range (INR)	748/492
1, 6, 12 Rel.Per (%)	-5/-20/-17
Avg Val, INRm	1,163
Free float (%)	63.2

CMP: INR495
TP: INR540 (+9%)
Neutral

4QFY16 margin falls significantly short of estimate due to one-offs

■ Cipla reported revenue of INR32b (up 8% YoY) for 4QFY16, which was in line with our estimate, led by strong domestic sales growth (up 16% YoY), partially offset by weak export business growth (up 2% YoY). Reported EBITDA came in at INR2.2b (down 57% YoY), which was 64% lower than our estimate due to one-offs related to inventory write off, restructuring and incremental R&D spend. Reported EBITDA margin came in at 6.7% as against our estimate of 18.2%. After adjusting for one-offs, EBITDA stood at INR5.1b (14% lower than our estimate) and EBITDA margin stood at 15.8%.

■ **Domestic growth bounces back; export sales lower than expected:** Domestic formulation sales grew by 15-16% YoY in 4QFY16 on the back of a ramp-up of the company's Hepatitis portfolio. Export formulations grew by 2% YoY primarily on account of a high base effect and re-classification of sales in South Africa. We believe that the US will be the key growth driver in FY17 on the back of the Invagen amalgamation and 15-16 new ANDA approvals. Management has guided for a base business revenue growth in the mid-teens over the medium term with an EBITDA growth of ~15-20%. Excluding the impact of Nexium and Invagen, we estimate a revenue growth of ~15% in FY17E (in line with the company's guidance).

■ **Earnings call takeaways:** a) Cipla's 4QFY16 numbers included 40 days of Invagen sales; b) R&D as % of sales is expected to be ~8% in FY17, as against ~6.5% in FY16; c) Invagen acquisition to be completed by 4QFY16; d) Expected 5-7 ANDA approvals from Invagen and 8-10 from Cipla; e) 20-25 ANDA fillings expected in FY17; f) Nexium sales remained flat QoQ; g) FY17 capex guidance at ~8% of sales (in line with FY16); h) Impact of DPCO and FDC ban on domestic market expected to be ~2-3% for FY17; i) Cipla's own annual DTM sales run rate stands at ~USD50m; j) The company has replied to all queries from the UK regulator regarding Advair launch; k) Pending ANDAs in the US stands at 78 (including Invagen portfolio).

■ **Valuation and view:** We see potential for limited downside in the stock from the current levels, but expect margins of the base business to be impacted by higher R&D expenses and front-end set up costs. We maintain Neutral rating on the stock with a TP of INR540 @ 18x FY18E PER (as against INR600 @ 18x). We have lowered our FY17/18E EPS estimates by 5-6% to factor in the slower pace of margin improvement.

Financials & Valuation (INR b)

Y/E Mar	2016	2017E	2018E
Net Sales	136.8	164.4	190.1
EBITDA	25.0	33.7	41.8
PAT	15.1	19.3	24.2
EPS (INR)	18.8	24.1	30.1
Gr. (%)	33.5	28.3	25.0
BV/Sh (INR)	147.5	168.6	195.7
RoE (%)	12.7	14.3	15.4
RoCE (%)	11.0	11.7	13.1
P/E (x)	26.4	20.6	16.5
P/BV (x)	3.4	2.9	2.5

Estimate change



TP change



Rating change



Quarterly Performance

Y/E March	FY15				FY16				FY15	FY16	Est.	% Chg.
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Net Revenues	27,200	27,673	27,655	30,927	38,528	34,524	31,066	32,665	113,454	137,006	32,961	-0.9
YoY Change (%)	10.4	10.1	7.2	22.7	41.6	24.8	12.3	5.6	12.3	20.8	6.6	
EBITDA	5,418	5,584	5,538	5,077	10,390	7,894	4,537	2,190	21,617	25,234	5,997	-63.5
Margins (%)	19.9	20.2	20.0	16.4	27.0	22.9	14.6	6.7	19.1	18.4	18.2	
Depreciation	1,254	1,220	1,216	1,357	1,288	1,340	1,375	1,414	5,047	5,417	1,374	
Interest	333	469	447	434	514	503	230	368	1,683	1,613	435	
Other Income	404	233	407	612	489	259	793	547	1,656	2,089	459	
PBT after EO expense	4,235	4,128	4,282	3,898	9,078	6,311	3,726	955	16,543	20,293	4,646	-79.4
Tax	1,019	1,007	944	1,030	2,503	1,812	120	-39	4,000	4,396	1,140	
Rate (%)	24.1	24.4	22.1	26.4	27.6	28.7	3.2	-4.1	24.2	21.7	24.5	
Minority Interest	269.9	134.4	58.9	271.3	68.8	186.1	174.2	185.4	734.5	614.5	150.9	
Reported PAT	2,946	2,987	3,279	2,597	6,506	4,312	3,432	809	11,808	15,283	3,356	-75.9
YoY Change (%)	-38.0	-16.6	15.3	-0.4	120.9	44.4	4.7	-68.9	-16.6	29.4	29.2	
Margins (%)	10.8	10.8	11.9	8.4	16.9	12.5	11.0	2.5	10.4	11.2	10.2	

E: MOSL Estimates;

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

4Q Result Snapshot

Exhibit 1: Quarterly Profit and Loss statement

(INR m)	4Q FY15	3Q FY16	4Q FY16	%YoY	%QoQ	FY15	FY16	%YoY
Total revenues	29,807	30,273	32,067	7.6	5.9	108,824	133,720	22.9
Other operating income	1,120	793	599	-46.5	-24.5	4,630	3,063	-33.9
Total sales	30,927	31,066	32,665	5.6	5.2	113,454	136,783	20.6
Cost of revenues	11,588	12,338	14,160	22.2	14.8	41,897	51,184	22.2
Gross profit	19,339	18,727	18,506	-4.3	-1.2	71,557	85,599	19.6
Gross margin (%)	62.5	60.3	56.7	(588)bp	(363)bp	63.1	62.6	(49)bp
Staff cost	5,147	5,862	6,591	28.1	12.4	19,737	24,471	24.0
% of Total Revenues	16.6	18.9	20.2	353 bp	131 bp	17.4	17.9	49 bp
Other expense	9,115	8,328	9,725	6.7	16.8	30,204	36,118	19.6
% of Total Revenues	29.5	26.8	29.8	30 bp	296 bp	27.8	27.0	(74)bp
EBITDA	5,077	4,537	2,190	-56.9	-51.7	21,617	25,011	15.7
EBITDA margin (%)	16.4	14.6	6.7	(971)bp	(790)bp	19.1	18.3	(77)bp
Depreciation	1,357	1,375	1,414	4.2	2.9	5,047	5,417	7.3
EBIT	3,720	3,162	775	-79.2	-75.5	16,570	19,594	18.3
Interest cost	434	230	368	-15.2	60.2	726	1,613	122.2
Other income (net)	612	793	547	-10.6	-31.0	1,226	2,089	70.5
PBT	3,898	3,726	955	-75.5	-74.4	17,069	20,070	17.6
Income tax	1030	120	-39	-103.8	-132.6	4000	4396	9.9
Effective tax rate (%)	26.4	3.2	-4.1	(3,051)bp	(730)bp	23.4	21.9	(153)bp
Reported Profit	2,868	3,606	994	-65.3	-72.4	13,069	15,674	19.9
Share of profits	-28	-35	-54	91.8	53.4	-253	-120	-52.5
Minority Interest	243.3	139.2	132	-45.9	-5.4	481.5	494	2.7
Adjusted Net Profit	2,597	3,432	809	-68.9	-76.4	12,335	15,059	22.1

Source: Company, MOSL

Exhibit 2: EBITDA One off in 4Q

	4QFY15	4QFY16
Reported EBITDA (INR m)	5,080	2,190
EBITDA Margin (%)	16.4	6.7
Adjustments (%)		
Non-moving inventory write off		1.3
Inventory reduction		2.1
Complexity reduction - restructuring and rationalization		2.1
Other one offs		1.3
Incremental R&D		2.2
EBITDA (Adjusted)	16.4	15.8

Source: Company, MOSL

Operating metrics

Exhibit 3: Key operating metrics

	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16
Revenue Mix (%)												
India	48.9	42.2	40.9	37.4	48.7	47.6	45.7	36.4	37.0	37.5	39.4	39.2
Exports form	44.7	49.5	53.0	52.8	46.0	47.3	48.3	56.7	57.6	55.7	55.8	53.9
Exports API	6.3	8.3	6.1	9.8	5.3	5.2	6.0	6.9	5.5	6.7	4.8	6.8
Revenue Gr. (%)												
	18.7	13.3	23.7	26.4	14.5	6.8	2.8	22.7	42.7	27.8	15.3	7.5
India	16.7	8.1	9.1	14.5	13.9	20.3	14.8	19.6	8.4	0.9	(0.4)	15.8
Exports form	27.7	17.3	39.5	34.4	17.7	2.0	(6.1)	31.8	78.5	50.8	33.1	2.3
Exports API	(13.1)	17.6	14.2	36.8	(4.2)	(33.5)	(0.2)	(14.2)	46.9	66.2	(8.2)	7.0
As % of sales												
Raw material	41.3	38.4	39.1	41.3	38.7	38.6	37.7	38.9	33.1	36.2	40.8	44.2
Staff cost	13.4	14.7	15.8	17.6	18.1	18.0	19.3	17.3	16.4	17.4	19.4	20.6
Other expenses	23.6	25.9	27.9	27.9	25.4	27.4	27.3	30.6	24.9	25.6	27.5	30.3
Tax Rate	24.0	27.0	25.0	21.7	24.1	24.4	22.1	26.4	27.6	28.7	3.2	(4.1)
Margins (%)												
Gross Margins	58.7	61.6	60.9	58.7	61.3	61.4	62.3	61.1	66.9	63.8	59.2	55.8
EBITDA Margins	27.4	22.5	18.1	16.2	19.9	20.2	20.0	16.4	27.0	22.9	14.6	6.7
EBIT Margins	29.1	22.3	16.8	15.7	17.3	17.5	18.0	14.5	25.4	20.3	13.1	4.1
PAT margins	20.8	14.5	11.1	10.7	11.1	11.4	12.5	8.7	17.2	12.8	11.3	2.5

Source: Company; MOSL

Valuation and view

CIPLA has corrected sharply on delay in inhaler launches and US FDA concerns on few recently inspected plants. However, monetization of its inhaler portfolio in the developed markets continues to remain key near trigger for the stock. Cipla currently trades at 20.6x FY17E and 16.5x FY18E (P/E).

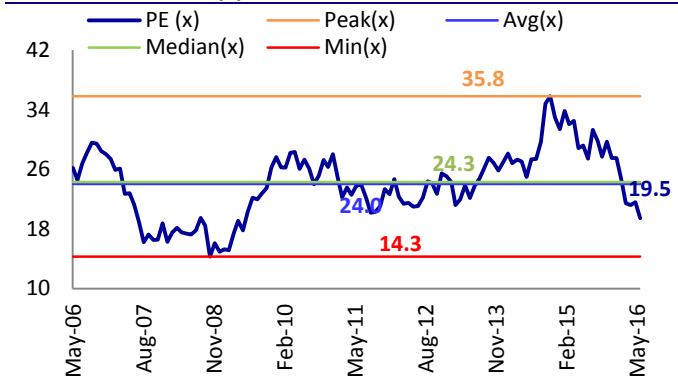
We assign a target P/E of 18x on FY18E core EPS, at 20% discount to sector average (one-year forward P/E):

- Low EBITDA margins at 19-21% (FY14/15).
- Poor return ratios: RoE at 11% and ROCE at 14% in FY15
- Weak cash flow generation (INR6b over FY11-15)

Key catalysts to drive stock’s performance over the medium term are:

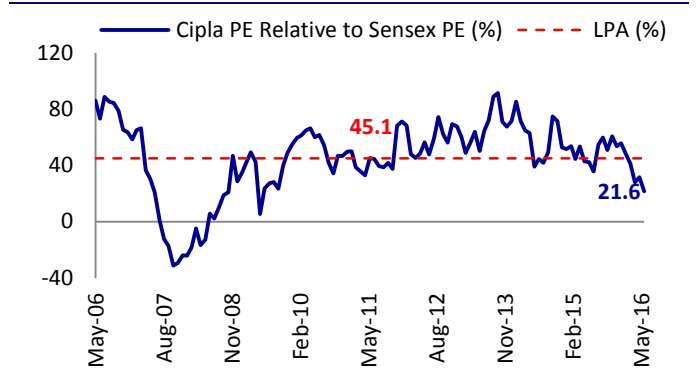
- Launch of combination inhaler in UK market (USD 450m mkt size, few players)
- Stronger performance in the US with Invagen portfolio.
- Margin improvement in Medpro operations (acquired in July 2014)
- Sustained strong growth in domestic formulations (42% of sales)

Exhibit 4: PE Band (x)



Source: Company, MOSL

Exhibit 5: PE relative to Sensex



Source: Company, MOSL

Story in charts

Exhibit 6: Sales growth at 6%, led by US & SA

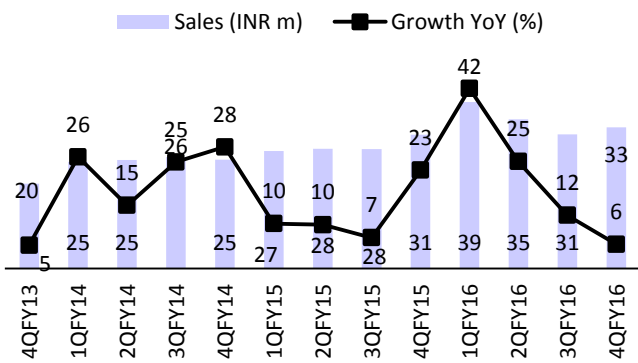


Exhibit 7: India business reported good growth in 4Q

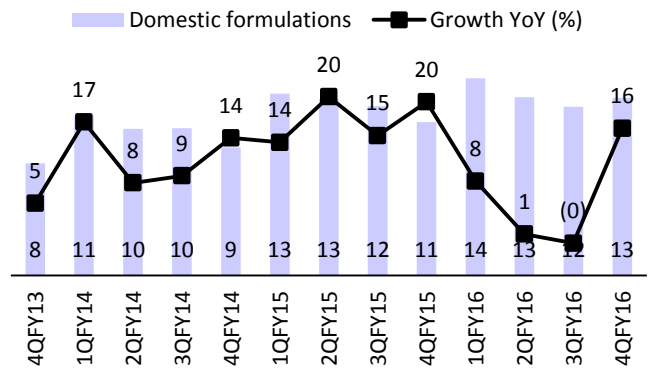


Exhibit 8: North America biz driving exports form.

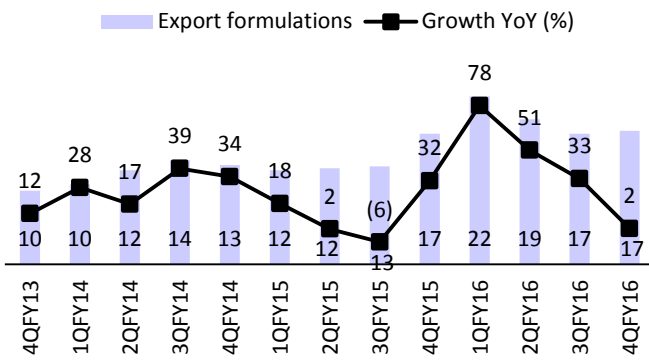


Exhibit 9: Exports API sales trend

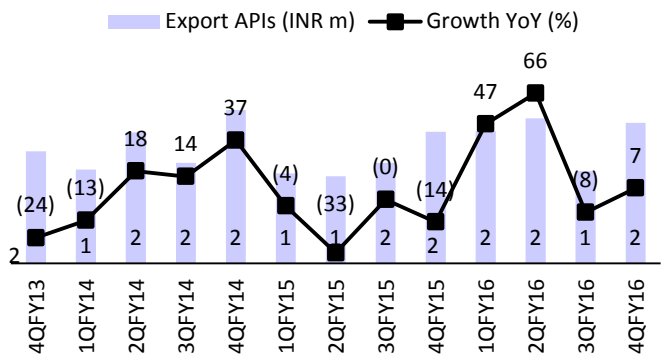


Exhibit 10: EBITDA margins trend

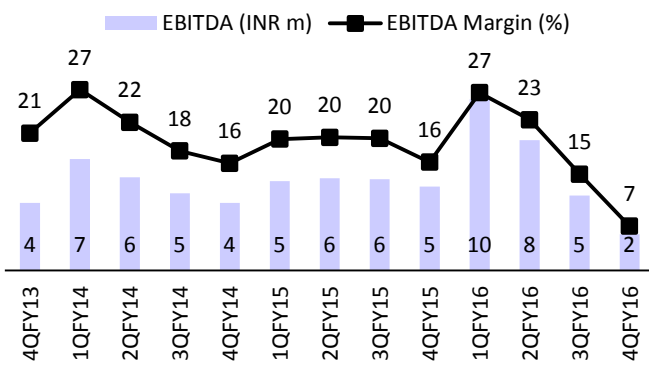


Exhibit 11: One offs affected gross margins

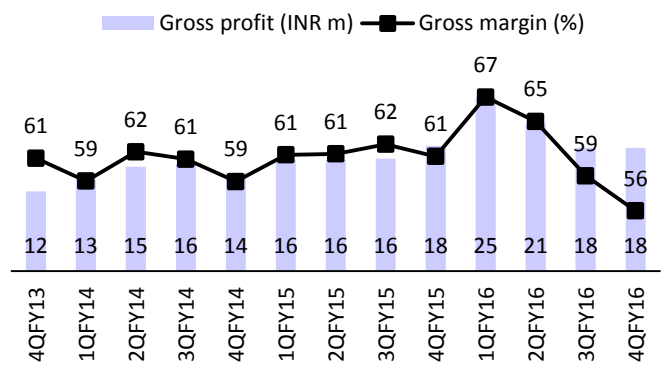
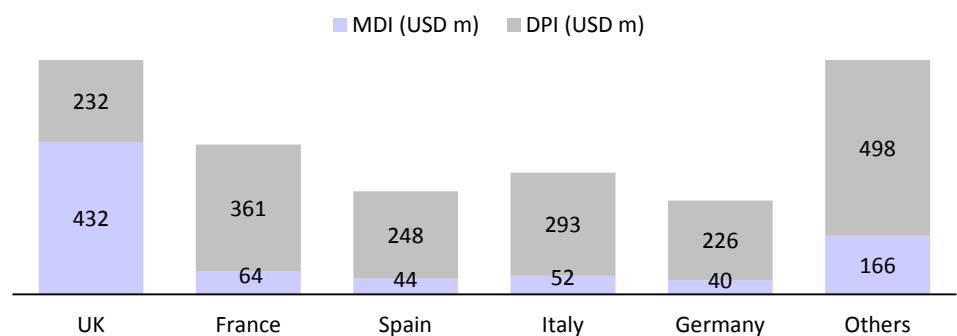


Exhibit 12: EU inhaler market – Cipla likely to launch MDI products over next 12-18 months



Source: Company, MOSL

Exhibit 13: Formulation led sales growth

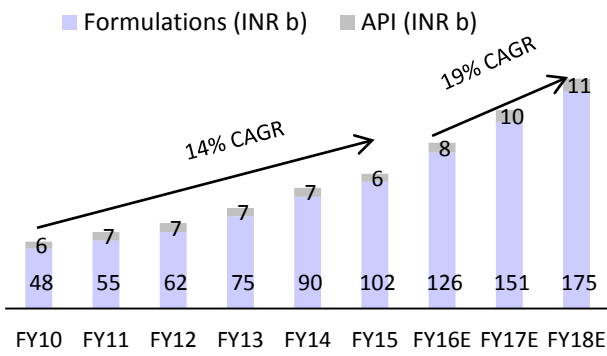


Exhibit 14: EBITDA margins to stay in 20-22% range

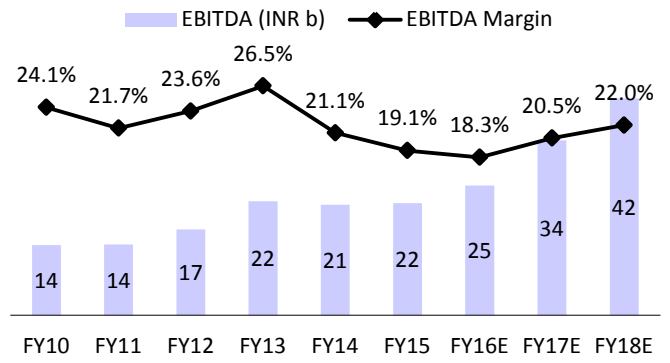


Exhibit 15: Inhaler launches to drive exports

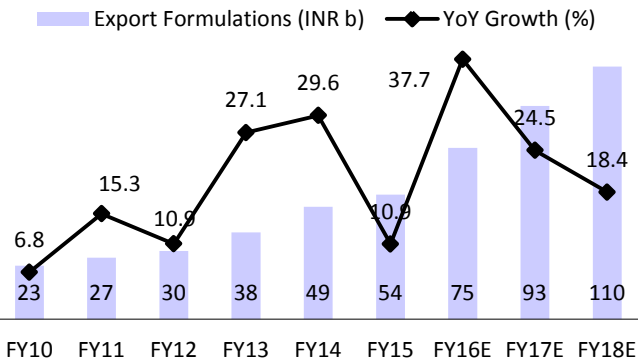


Exhibit 16: Higher earnings growth on a low base

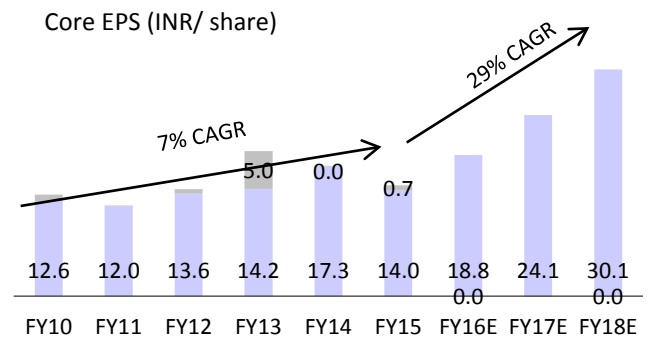


Exhibit 17: Steady ramp up in India formulation business

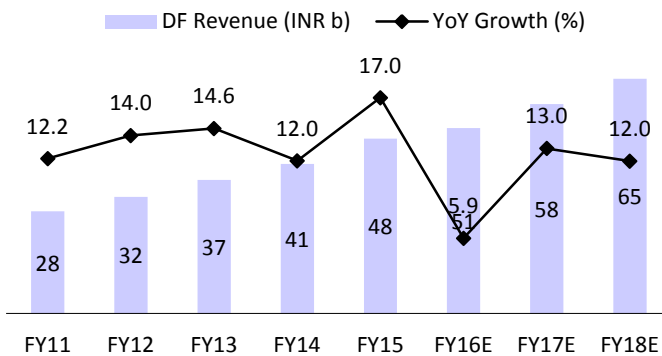


Exhibit 18: Better inventory management to improve cash cycle

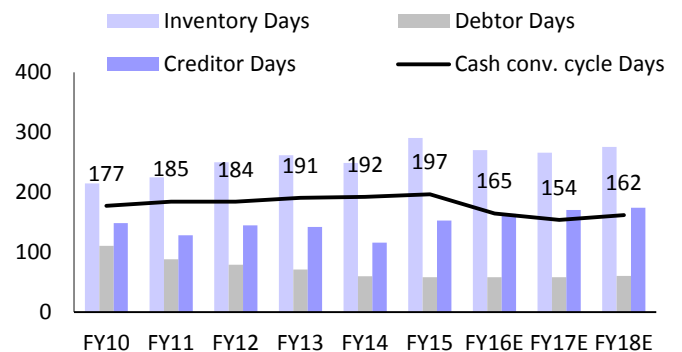


Exhibit 19: Return ratios to remain under pressure

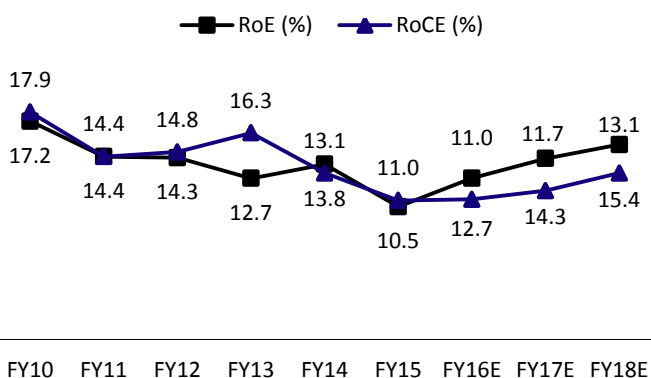
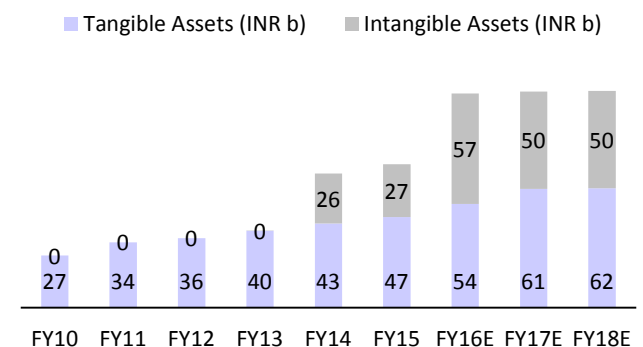


Exhibit 20: Intangible asset on account of Medpro acquisition and Invagen



Source: Company, MOSL

Source: Company, MOSL

Financials and valuations

Key assumption

Segment growth	2011	2012	2013	2014	2015	2016	2017E	2018E
India	12.2	14.0	14.6	12.0	17.0	6.0	14.0	14.0
Exports form	15.3	10.9	27.1	29.6	10.9	40.6	24.1	23.6
Exports API	17.1	6.6	-9.7	13.3	-13.9	31.7	13.4	13.3
Total sales	14.1	11.9	17.4	20.3	11.6	24.7	19.6	19.5
Expenses								
Raw material	43.9	39.0	35.7	38.4	36.9	36.0	35.3	34.8
Staff cost	8.9	11.0	12.5	15.3	17.4	17.1	17.2	17.0
EBITDA Margins	21.7	23.6	26.5	21.1	19.1	21.7	21.6	22.7

Income Statement

(INR Million)

Y/E March	2011	2012	2013	2014	2015	2016	2017E	2018E
Net Income	63,238	70,207	82,793	101,004	113,454	136,783	164,423	190,098
Change (%)	12.4	11.0	17.9	22.0	12.3	20.6	20.2	15.6
EBITDA	13,692	16,589	21,979	21,331	21,617	25,011	33,707	41,822
Change (%)	1.2	21.2	32.5	-2.9	1.3	15.7	34.8	24.1
Margin (%)	21.7	23.6	26.5	21.1	19.1	18.3	20.5	22.0
Depreciation	2,733	3,122	3,305	3,726	5,047	5,417	7,512	7,810
EBIT	10,959	13,466	18,674	17,604	16,570	19,594	26,195	34,011
Int. and Finance Charges	173	238	276	711	726	1,613	2,336	2,596
Other Income - Rec.	711	722	1,323	1,500	1,226	2,089	2,800	2,900
PBT before EO Items	11,497	13,950	19,721	18,393	17,069	20,070	26,659	34,316
Extra Ordinary Expense	-90	-369	-1,233	-408	527	0	0	0
PBT but after EO Exp.	11,586	14,319	20,954	18,800	16,543	20,070	26,659	34,316
Tax	1,914	2,907	5,443	4,634	4,000	4,396	6,638	9,265
Tax Rate (%)	16.5	20.3	26.0	24.6	24.2	21.9	24.9	27.0
Minority Interest			0.0	159	482	494	500	600
Income from associates			-62	-123	-253	-120	-200	-300
Reported PAT	9,673	11,412	15,449	13,884	11,808	15,059	19,321	24,150
Adj PAT	9,598	10,927	11,440	13,859	11,281	15,059	19,321	24,150
Change (%)	-5.4	13.9	4.7	21.1	-18.6	33.5	28.3	25.0
Margin (%)	15.2	15.6	13.8	13.7	9.9	11.0	11.8	12.7

Balance Sheet

(INR Million)

Y/E March	2011	2012	2013	2014	2015	2016	2017E	2018E
Equity Share Capital	1,606	1,606	1,606	1,606	1,606	1,607	1,607	1,607
Reserves	64,966	74,694	88,491	98,808	106,197	116,878	133,850	155,652
Net Worth	66,661	76,389	90,187	100,504	107,892	118,574	135,547	157,349
Loans	5,410	135	9,971	12,609	17,018	51,914	51,914	51,914
Deferred Liabilities	2131	2332	2805	3090	2846	3664	4473	4473
Minority Interst	0	0	0	496	1927	2696	2696	2696
Capital Employed	74,202	78,856	102,963	116,698	129,684	176,848	194,630	216,432
Gross Block	42,406	46,269	53,279	87,604	95,935	144,709	148,471	156,471
Less: Accum. Deprn.	11,464	14,111	17,076	21,757	27,178	34,427	42,066	49,748
Net Fixed Assets	30,942	32,158	36,203	65,847	68,757	110,282	106,405	106,723
Capital WIP	2,853	3,712	3,674	3,536	5,349	5,349	5,349	5,349
Investments	5,908	12,688	25,324	7,086	6,398	7,569	7,569	7,569
Curr. Assets	46,263	44,945	51,376	57,535	76,201	84,916	114,399	140,812
Inventory	19,061	18,501	23,871	28,953	37,806	38,080	46,988	53,560
Account Receivables	14,908	15,536	16,688	16,389	20,043	23,593	29,103	33,647
Cash and Bank Balance	960	905	1,430	1,752	5,643	8,714	17,385	30,978
Others	11,334	10,003	9,387	10,442	12,710	14,529	20,923	22,627
Curr. Liability & Prov.	11,764	14,646	13,615	17,306	27,021	31,269	39,092	44,021
Account Payables	9,562	12,214	10,791	13,882	21,215	24,761	29,769	33,733
Provisions	2,203	2,432	2,824	3,424	5,806	6,508	9,323	10,288
Net Current Assets	34,499	30,299	37,761	40,229	49,180	53,648	75,307	96,791
Appl. of Funds	74,202	78,856	102,963	116,698	129,684	176,848	194,630	216,432

Financials and valuations

Ratios

Y/E March	2011	2012	2013	2014	2015	2016	2017E	2018E
EPS	12.0	13.6	14.2	17.3	14.0	18.8	24.1	30.1
Cash EPS	15.4	17.5	18.4	21.9	20.3	25.5	33.4	39.8
BV/Share	82.9	95.0	112.2	125.1	134.3	147.5	168.6	195.7
DPS	0.3	0.2	2.0	2.0	2.0	2.2	2.5	2.5
Payout (%)	30.8	14.4	12.2	13.5	15.9	14.0	12.2	9.7

Valuation (x)

P/E					35.2	26.4	20.6	16.5
Cash P/E					24.3	19.4	14.8	12.4
P/BV					3.7	3.4	2.9	2.5
EV/Sales					3.6	3.2	2.6	2.2
EV/EBITDA					18.9	17.6	12.8	10.0
Dividend Yield (%)					0.4	0.5	0.5	0.5

Return Ratios (%)

RoE	14.4	14.3	12.7	13.8	10.5	12.7	14.3	15.4
RoCE	14.4	14.8	16.3	13.1	11.0	11.0	11.7	13.1
RoIC	15.8	17.0	20.6	15.0	11.6	11.4	12.3	14.7

Working Capital Ratios

Fixed Asset Turnover (x)	2.5	2.2	2.4	2.0	1.7	1.5	1.5	1.8
Debtor (Days)	86	81	74	59	64	63	65	65
Inventory (Days)	110	96	105	105	122	102	104	103
Working Capital (Days)	194	153	160	136	144	143	167	186

Leverage Ratio (x)

Current Ratio	3.9	3.1	3.8	3.3	2.8	2.7	2.9	3.2
Debt/Equity	0.1	0.0	0.1	0.1	0.1	0.4	0.3	0.1

Cash Flow Statement

(INR Million)

Y/E March	2011	2012	2013	2014	2015	2016	2017E	2018E
Op. Profit/(Loss) before Tax	13,692	16,589	21,979	21,331	21,617	25,011	33,707	41,822
Interest/Dividends Recd.	711	722	1,323	1,500	1,226	2,089	2,800	2,900
Direct Taxes Paid	-1,574	-2,706	-4,970	-4,349	-4,244	-3,578	-5,829	-9,265
(Inc)/Dec in WC	-2,630	4,145	-6,937	-2,147	-5,060	-1,396	-12,988	-7,892
CF from Operations	10,199	18,750	11,395	16,334	13,539	22,125	17,689	27,565
EO expense	-90	-369	-1,233	-408	527	0	0	0
CF from Oper. incl EO Expense	10,289	19,119	12,627	16,741	13,012	22,125	17,689	27,565
(inc)/dec in FA	-9,574	-5,197	-7,313	-33,232	-9,769	-46,942	-3,635	-8,128
Free Cash Flow	715	13,922	5,314	-16,491	3,242	-24,817	14,055	19,437
(Pur)/Sale of Investments	-3,444	-6,780	-12,636	18,239	688	-1,171	0	0
CF from Investments	-13,018	-11,977	-19,949	-14,993	-9,082	-48,114	-3,635	-8,128
Issue of Shares	866	-39	228	-1,689	-1,109	-1,495	0	0
Inc/(Dec) in Debt	5,359	-5,275	9,836	2,638	4,409	34,896	0	0
Interest Paid	-173	-238	-276	-711	-726	-1,613	-2,336	-2,596
Dividend Paid	-2,983	-1,645	-1,879	-1,879	-1,879	-2,114	-2,348	-2,348
Others	-1	1	-62	213	-735	-615	-700	-900
CF from Fin. Activity	3,068	-7,197	7,847	-1,427	-39	29,060	-5,385	-5,844
Inc/Dec of Cash	339	-55	526	321	3,891	3,072	8,670	13,593
Add: Beginning Balance	621	960	905	1,430	1,752	5,643	8,714	17,385
Closing Balance	960	905	1,430	1,751	5,643	8,714	17,384	30,978

Corporate profile: Cipla

Company description

Cipla is the largest player in the domestic formulations market and has a presence across most therapeutic areas. The company also has robust exports to several markets including US, Europe, South Africa, Australia and the Middle East. Cipla's strategy for regulated markets (Europe and US) exports is built around supply tie-ups with global players.

Exhibit 21: Sensex rebased

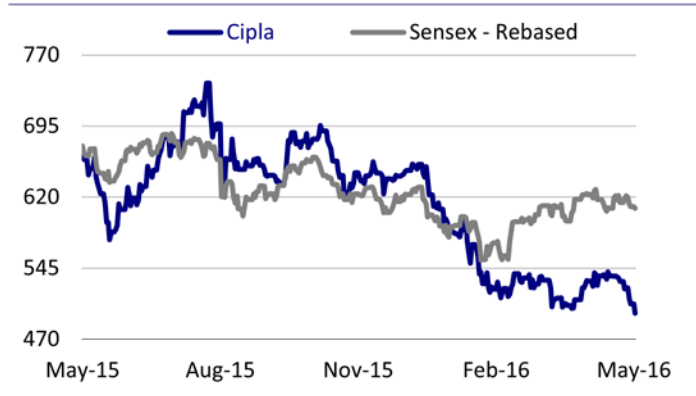


Exhibit 22: Shareholding pattern (%)

	Mar-16	Dec-15	Mar-15
Promoter	36.8	36.8	36.8
DII	14.5	12.2	9.8
FII	21.6	24.7	27.6
Others	27.1	26.3	25.8

Note: FII Includes depository receipts

Exhibit 24: Top management

Name	Designation
Y K Hamied	Chairman
M K Hamied	Vice Chairman
Subhanu Saxena	Managing Director & CEO
Mital Sanghvi	Company Secretary

Exhibit 23: Top holders

Holder Name	% Holding
Life Insurance Corporation of India*	6.0
ICICI Prudential Mutual Fund	4.3
Abu Dhabi Investment Authority*	1.1

Exhibit 25: Directors

Name	Name
Y K Hamied	Nachiket Mor
M K Hamied	Punita Lal*
Subhanu Saxena	S Radhakrishnan
Ashok Sinha*	Samina Vaziralli
Peter Mugenyi*	Adil Zainulbhai

*Independent

Exhibit 26: Auditors

Name	Type
R G N Price & Co	Statutory
V Sankar Aiyar & Co	Statutory
D H Zaveri	Cost Auditor

Exhibit 27: MOSL forecast v/s consensus

EPS (INR)	MOSL forecast	Consensus forecast	Variation (%)
FY17	24.1	26.1	-7.8
FY18	30.1	31.9	-5.7

NOTES

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