

Cipla

Performance Highlights

Y/E March (₹ cr)	3QFY2011	2QFY2011	% chg qoq	3QFY2010	% chg yoy
Net sales	1,501	1,580	(5.0)	1,344	11.7
Other income	78	52	49.7	112	(30.2)
Gross profit	806	831	(3.1)	719	12.0
Operating profit	266	331	(19.7)	286	(6.9)
Net profit	233	263	(11.5)	289	(19.4)

Source: Company, Angel Research

For 3QFY2011, Cipla reported lower-than-expected numbers, majorly on account of higher-than-expected employee expenses. The Indore SEZ (₹900cr invested) is expected to contribute from FY2012, which would boost the company's overall growth and margins. **We recommend Buy with a Target Price of ₹388, valuing the stock at 18.4x FY2012E earnings.**

Results impacted by increased employee costs: Cipla reported net sales of ₹1,501cr (₹1,334cr), below our estimates of ₹1,552cr. With gross margins being flat at 53.7% (53.5%), OPM declined to 17.7% yoy (21.2%), majorly due to increased employee and other expenses. Exports realisations also took a hit due to a 4% appreciation in the rupee. The technical know-how fees reported a drop of 78.5% to ₹15.1cr (₹70.3cr) on account of a higher comparative base yoy, which included one-time fees reported in 3QFY2010. Consequently, net profit also came in below our estimates at ₹233cr (₹288.5cr), a drop of 19.4% during the quarter.

Outlook and valuation: We maintain our estimates of net sales posting a 14.4% CAGR to ₹7,009cr and EPS to record a 14.4% CAGR to ₹17.6 over FY2010–12E. The stock is trading at 24.9x and 18.4x FY2011E and FY2012E earnings, respectively. We recommend Buy on the stock with a Target Price of ₹388.

Key financials (Consolidated)

Y/E March (₹ cr)	FY2009	FY2010	FY2011E	FY2012E
Net sales	4,961	5,358	6,006	7,009
% chg	23.7	8.0	12.1	16.7
Net profit	771	1,081	1,047	1,415
% chg	9.9	40.2	(3.1)	35.1
EPS (₹)	9.9	13.5	13.0	17.6
EBITDA Margin (%)	19.1	19.9	20.2	22.4
P/E (x)	32.7	24.1	24.9	18.4
RoE (%)	24.8	19.2	16.6	19.5
RoCE (%)	16.1	15.6	15.3	17.5
P/BV (x)	5.8	4.4	3.9	3.3
EV/Sales (x)	5.3	4.8	4.3	3.7
EV/EBITDA (x)	27.5	24.4	21.4	16.4

Source: Company, Angel Research

BUY

CMP	₹324
Target Price	₹388

Investment Period	12 months
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Stock Info

Sector	Pharmaceutical
Market Cap (₹cr)	26,030
Beta	0.5
52 Week High / Low	381 / 300
Avg. Daily Volume	238951
Face Value (₹)	2
BSE Sensex	18,008
Nifty	5,396
Reuters Code	CIPL.BO
Bloomberg Code	CIPLA@IN

Shareholding Pattern (%)

Promoters	36.8
MF / Banks / Indian Fls	18.7
FII / NRIs / OCBs	18.7
Indian Public / Others	25.8

Abs. (%)	3m	1yr	3yr
Sensex	(13.8)	11.0	(3.5)
Cipla	(7.2)	3.5	62.6

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Exhibit 1: 3QFY2011 performance (Consolidated)

Y/E March (₹cr)	3QFY2011	2QFY2011	% chg qoq	3QFY2010	% chg yoy	9MFY2011	9MFY2010	% chg yoy
Net sales	1,501	1,580	(5.0)	1,344	11.7	4,509	4,041	11.6
Other income	78.0	52.1	49.7	111.7	(30.2)	199.2	259.0	(23.1)
Total income	1,579	1,632	(3.2)	1,456	8.5	4,708	4,300	9.5
Gross profit	806	831	(3.1)	719	12.0	2394	2170	10.3
Gross margin	53.7	52.6		53.5		53.1	53.7	
Operating profit	266	331	(19.7)	286	(6.9)	895	885	1.1
OPM (%)	17.7	21.0		21.2		19.9	21.9	
Interest	2.9	0.3	946.4	4.4	(33.0)	3.3	23.2	(85.7)
Depreciation	65	64	2.1	46	42.9	184	139	32.1
PBT	276	319	(13.6)	347	(20.6)	907	982	(7.6)
Provision for taxation	43	56	(23.2)	59	(26.7)	154	176	(12.5)
PAT before extra-ordinary items	233	263	(11.5)	289	(19.4)	753	806	(6.6)
Extra-ordinary items/(income)	0	0		0		0	0	
PAT after extra-ordinary items	233	263	(11.5)	289	(19.4)	753	806	(6.6)
EPS (₹)	2.9	3.3		3.6		9.4	10.0	

Source: Company, Angel Research

Exhibit 2: 3QFY2011 – Actual v/s Angel estimates

(₹cr)	Actual	Estimates	Variance
Net sales	1,501	1,552	(3.3)
Other income	78	59	32.4
Operating profit	266	316	(15.9)
Tax	43	56	(22.9)
Net profit	233	261	(10.9)

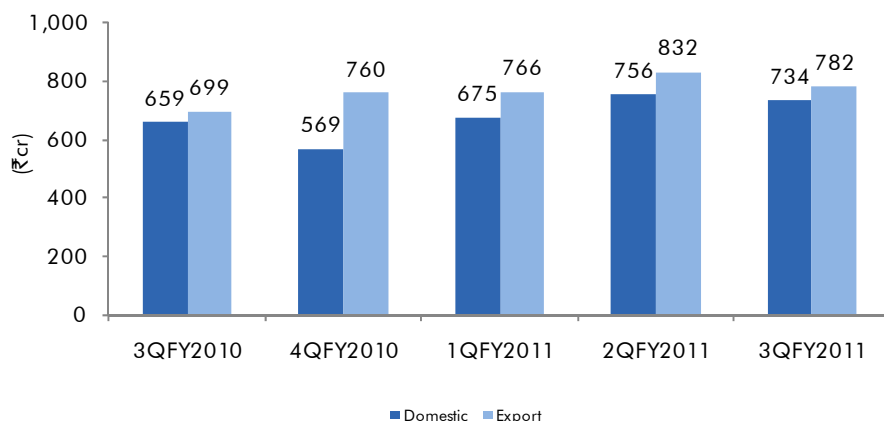
Source: Company, Angel Research

Results impacted by higher employee costs: Cipla reported net sales of ₹1,501cr (₹1,334cr) in 3QFY2011, below our estimates of ₹1552cr mainly led by the higher-than-expected employee expenses during the quarter. The domestic formulations segment grew by 11.3% to ₹734cr (₹659cr).

On the exports front, despite the 4% appreciation in the rupee, which impacted realisations, overall exports increased by 12% to ₹782cr (₹699cr); however, this was below our estimates of ₹832cr. The formulations segment reported 11.7% yoy growth in export sales to ₹643cr (₹576cr) and API sales reported 12.8% growth to ₹139cr (₹123cr).

The technical know-how fees also dropped by 78.5% yoy to ₹15.1cr (₹70.3cr) on account of the higher comparative base yoy, which included one-time fees reported in 3QFY2010.

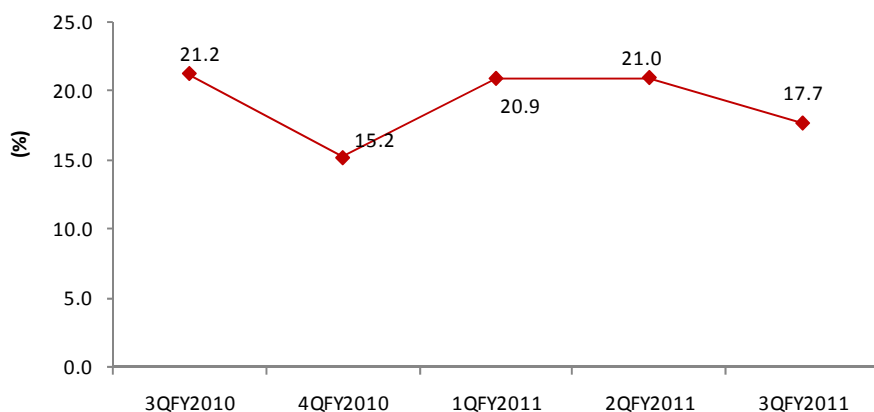
Exhibit 3: Sales trend



Source: Company, Angel Research

OPM drops due to Indore SEZ commercialisation costs: Cipla’s OPM dropped to 17.7% (21.2%) during the quarter, on account of increased factory overheads at the Indore SEZ, with employee costs increasing by 52% to ₹135cr (₹92cr) as well as other expenses increasing by 17.3% to ₹405cr (₹345cr). The company indicated that it has incurred ₹25cr–30cr as overheads (excluding salary cost) on Indore SEZ for the quarter without any commensurate revenue flow.

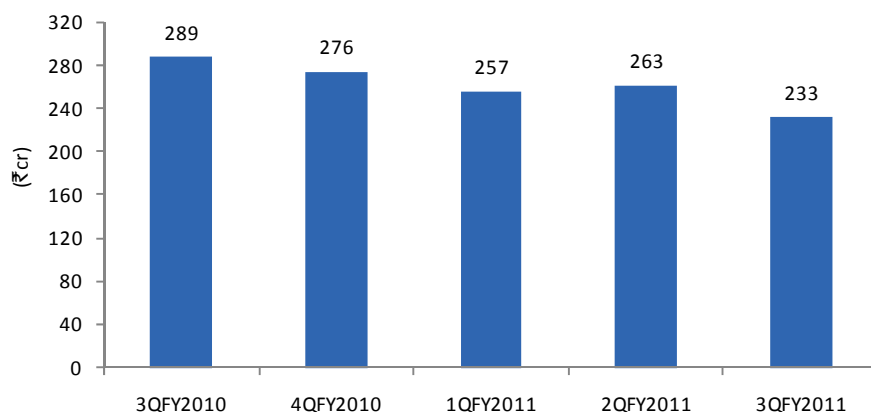
Exhibit 4: OPM trend



Source: Company, Angel Research

Net profit impacted by lower technical know-how fees: Cipla reported net profit of ₹233cr (₹289cr), down 19.4% yoy, during the quarter. This was on the back of lower-than-expected technical know-how fees, which declined by 78.5% yoy to ₹15cr (₹70.3cr). Going forward, the company expects the technical know-how fees to increase with the commercialisation of products that are currently in the pipeline for the regulated markets, though at a slower pace compared to the past. Also, depreciation expenses increased by 43% to ₹65cr (₹46cr), factoring the addition of fixed assets on account of the Indore SEZ commercialisation.

Exhibit 5: Net profit trend



Source: Company, Angel Research

Concall takeaways

- The company did not enter into any new partnership in 9MFY2011. Management indicated having 22 partners for the US markets and around 50 for the European markets.
- As of 3QFY2011, Cipla reported to have 64 ANDAs approved and 46 under the registration process.
- Revenue from the Indore SEZ should start coming in post its ramp up and optimisation, estimated to take a year's time. Management indicated around 10% contribution to the revenue to start coming in from FY2013E.
- In terms of inhalers, management indicated that 5–6 products are at different stages of approvals, expecting a few to commercialise by next year. For combination inhalers for the European markets, management indicated having submitted dossiers for a few, with the others being in different stages of trials.

Investment arguments

Export segment to be the growth driver: Cipla exports to over 175 countries, with growth coming through marketing alliances and distribution tie-ups in various markets. Currently, exports contribute 54% of the total turnover of FY2010, with Africa, US and Latin America constituting more than 60% of total exports. In the US, Cipla has entered into a partnership with 22 players and has cumulative 64 approved ANDAs, of which 35 have been launched, while 46 are pending for approval. Further, Cipla has launched *Salbutamol* inhalers in the UK and has received approvals for *Budesonide* inhalers in Germany and Portugal and *Beclomethasone* in Portugal. Cipla has developed eight CFC-free inhalers for the EU region, of which six have been submitted for regulatory approvals. Launch of CFC-free inhalers in Europe and US with a potential market size of more than US \$3bn would be the long-term growth driver for the company. Management has also indicated that it is negotiating with MNCs such as Pfizer, GSK and Boehringer for long-term supply agreements.

Increasing penetration in the domestic market: Cipla is one of the largest players in the domestic formulation market, with a market share of around 5% contributing 46% of the total turnover in FY2010. The company is the market leader in key therapeutic areas such as respiratory care, anti-viral and urological. Cipla's distribution network in India consists of a field force of around 5,100 employees and 42 exclusive and dedicated sales depots, as well as approximately 2,300 stockists and 160,000 chemists. Cipla plans to focus on growing its market share and sales by increasing penetration in the Indian market, especially in rural areas and plans to expand its product portfolio by launching biosimilars, particularly relating to the oncology, anti-asthmatic and anti-arthritis categories.

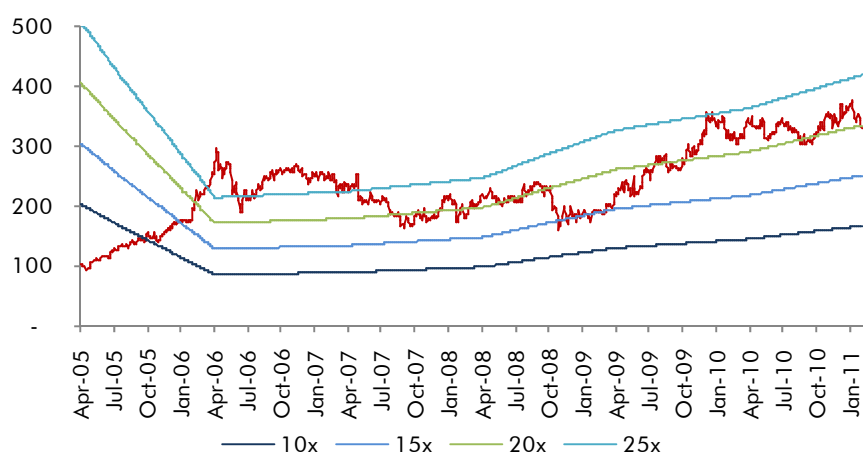
Return ratios to improve going ahead: Since FY2006, Cipla has incurred capex of ₹2,500cr (71% of GFA) for upgrading its existing manufacturing facilities at Kurkumbh, Patalganga, Bengaluru, Goa and Baddi, as well as for setting up new facilities in Sikkim and Indore. While Cipla has already commenced the Sikkim plant, the Indore SEZ has also commenced operations. With significant capex been incurred and with most of the facilities commercialised, management expects Cipla's return ratio to improve as productivity level increases.

Valuation: For FY2011, Cipla has guided for 8–10% overall revenue, including domestic growth of 8–10% and export growth of 10–12%. The company expects to maintain its current OPM of 20% (excluding the tech fees) for FY2011 also. Our FY2011 revenue estimates are higher than the company's guidance as we factor in higher revenue growth on the domestic front. Further, post the commencement of revenue flow from Indore SEZ in FY2012, we expect OPM (ex technical know-how fees) to expand from 20.2% to 22.4% in FY2012. As a result, we now estimate net sales to post a 14.4% CAGR to ₹7,009cr and EPS to record a 14.4% CAGR to ₹17.6 over FY2010–12E. **The stock is trading at 24.9x and 18.4x FY2011E and FY2012E earnings, respectively. We recommend Buy on the stock with a Target Price of ₹388.**

Exhibit 6: Key assumptions

	FY2011E	FY2012E
Domestic sales growth (%)	12.0	14.0
Export sales growth (%)	11.1	19.0
Growth in employee expenses (%)	31.7	16.7
Operating margins (excl tech-know fees) (%)	20.2	22.4
Capex (₹ cr)	598	500

Source: Company, Angel Research

Exhibit 7: One-year forward PE band


Source: Company, Angel Research

Exhibit 8: Recommendation summary

Company	Reco	CMP (₹)	Tgt. price (₹)	Upside %	FY2012E			FY10-12E		FY2012E
					PE (x)	EV/Sales (x)	EV/EBITDA (x)	CAGR in EPS (%)	RoCE (%)	ROE (%)
Alembic	Buy	68	92	35.7	7.2	0.8	5.4	78.7	20.6	25.7
Aurobindo Pharma	Accumulate	1,175	1,330	13.2	10.8	1.8	8.9	4.7	15.5	24.1
Aventis*	Neutral	1,882	-	-	21.5	3.0	17.3	13.1	16.9	18.2
Cadila Healthcare	Neutral	793	-	-	20.0	3.3	15.5	26.6	26.0	34.7
Cipla	Buy	324	388	19.7	18.4	3.7	16.4	14.4	17.5	19.5
Dr Reddy's	Neutral	1,580	-	-	20.3	2.5	13.1	99.8	23.8	25.5
Dishman Pharma	Buy	125	230	83.9	7.1	1.4	5.7	10.1	10.1	14.3
GSK Pharma*	Neutral	2,231	-	-	30.2	6.9	19.4	12.0	38.7	28.9
Indoco Remedies	Buy	442	541	22.3	8.2	1.0	5.9	25.7	16.8	18.2
Ipca labs	Neutral	287	-	-	12.4	1.8	8.6	18.7	23.3	25.1
Lupin	Accumulate	422	466	10.5	18.1	2.9	14.9	23.2	23.9	31.2
Orchid Chemicals	Neutral	289	-	-	17.4	2.1	11.0	-	7.0	12.7
Ranbaxy*	Neutral	525	-	-	18.7	2.2	11.7	99.7	18.4	19.8
Sun Pharma	Neutral	418	-	-	19.1	5.2	15.9	29.7	21.3	21.4

Source: Company, Angel Research; Note: * December year ending

Profit & loss statement (Consolidated)

Y/E March (₹ cr)	FY2007	FY2008	FY2009	FY2010	FY2011E	FY2012E
Gross sales	3,533	4,101	5,022	5,410	6,034	7,041
Less: Excise duty	94.9	90.7	61.0	52.2	28.1	32.1
Net Sales	3,438	4,010	4,961	5,358	6,006	7,009
Other operating income	124.8	207	276	265	200	265
Total operating income	3,563	4,217	5,236	5,623	6,206	7,274
% chg	139.9	18.4	24.2	7.4	10.4	17.2
Total expenditure	2,750	3,384	4,013	4,292	4,790	5,439
Net Raw Materials	1,726	2,054	2,347	2,453	2,793	3,192
Other Mfg costs	386.6	314	439	445	532	565
Personnel	184.6	214	271	319	420	491
Other	454	802	955	1,075	1,046	1,191
EBITDA	688	626	948	1,066	1,215	1,569
% chg	131.5	(8.9)	51.4	12.5	14.0	29.1
(% of Net Sales)	20.0	15.6	19.1	19.9	20.2	22.4
Depreciation & amortisation	103.4	116	152	167	221	260
EBIT	584	510	796	899	995	1,310
% chg	329.6	(12.7)	56.1	12.9	10.6	31.7
(% of Net Sales)	17.0	12.7	16.1	16.8	16.6	18.7
Interest & other charges	7	11	33	23	0	0
Other Income	105	133	90	88	83	101
(% of PBT)	13.0	15.8	7.9	7.2	6.5	6.0
Recurring PBT	807	838	1,129	1,230	1,277	1,676
% chg	235.0	3.8	34.7	8.9	3.9	31.2
Extraordinary expense/(Inc.)	-	-	233.3	(95.0)	-	-
PBT (reported)	807	838	895	1,325	1,277	1,676
Tax	140.0	136.9	124.5	243.5	229.9	261.4
(% of PBT)	17.3	16.3	13.9	18.4	18.0	15.6
PAT (reported)	667	701	771	1,081	1,047	1,415
PAT after MI (reported)	667	701	771	1,081	1,047	1,415
ADJ. PAT	667	701	1,004	986	1,047	1,415
% chg	356.9	5.1	43.3	(1.8)	6.2	35.1
(% of Net Sales)	19.4	17.5	15.5	20.2	17.4	20.2
Basic EPS (₹)	8.6	9.0	9.9	13.5	13.0	17.6
Fully Diluted EPS (₹)	8.6	9.0	9.9	13.5	13.0	17.6
% chg	(55.1)	5.1	9.9	35.8	(3.1)	35.1

Balance sheet (Consolidated)

Y/E March (₹ cr)	FY2007	FY2008	FY2009	FY2010	FY2011E	FY2012E
SOURCES OF FUNDS						
Equity Share Capital	155	155	155	161	161	161
Reserves & Surplus	3,081	3,600	4,192	5,750	6,554	7,637
Shareholders' Funds	3,236	3,755	4,348	5,911	6,715	7,798
Minority Interest	-	-	-	-	-	-
Total Loans	123.5	540.5	940.2	5.1	5.1	5.1
Deferred Tax Liability	112.7	149.2	164.2	179.2	222.6	250.2
Total Liabilities	3,472	4,445	5,452	6,095	6,942	8,053
APPLICATION OF FUNDS						
Gross Block	1,800	2,202	2,693	2,897	3,695	4,345
Less: Acc. Depreciation	412	540	701	886	1,105	1,365
Net Block	1,388	1,661	1,992	2,011	2,590	2,980
Capital Work-in-Progress	73	233	366	684	484	334
Investments	118	93	80	246	246	246
Current Assets	2,835	3,745	4,418	4,367	4,976	6,019
Cash	131	80	53	62	9	223
Loans & advances	696	1,138	1,113	1,226	1,243	1,451
Other	2,007	2,527	3,251	3,079	3,724	4,345
Current liabilities	941	1,288	1,405	1,214	1,355	1,526
Net current assets	1,893	2,457	3,013	3,153	3,621	4,492
Mis. Exp. not written off	-	-	-	-	-	-
Total Assets	3,472	4,445	5,452	6,095	6,942	8,053

Cash flow statement (Consolidated)

Y/E March (₹ cr)	FY2007	FY2008	FY2009	FY2010	FY2011E	FY2012E
Profit before tax	807	838	897	1,326	1,277	1,676
Depreciation	103	131	171	190	221	260
(Inc)/Dec in Working Capital	(428)	(404)	(711)	(174)	(521)	(658)
Less: Other income						
Direct taxes paid	93	171	65	256	222	282
Cash Flow from Operations	389	393	292	1,086	755	996
(Inc.)/Dec.in Fixed Assets	(421)	(563)	(700)	(526)	(598)	(500)
(Inc.)/Dec. in Investments	(96)	25	13	(166)	-	-
Other income	-	-	-	-	-	-
Cash Flow from Investing	(517)	(538)	(687)	(692)	(598)	(500)
Issue of Equity	767	-	-	669	-	-
Inc./Dec.) in loans	(344)	448	395	(935)	-	-
Dividend Paid (Incl. Tax)	(155)	(155)	(155)	(155)	(210)	(283)
Others	(52)	(200)	130	36	-	-
Cash Flow from Financing	215	93	369	(386)	(210)	(283)
Inc./Dec.) in Cash	87	(52)	(26)	9	(53)	213
Opening Cash balances	45	132	80	53	62	9
Closing Cash balances	132	80	53	62	9	223

Key ratios

Y/E March	FY2007	FY2008	FY2009	FY2010	FY2011E	FY2012E
Valuation Ratio (x)						
P/E (on FDEPS)	37.8	35.9	32.7	24.1	24.9	18.4
P/CEPS	32.7	30.8	27.3	20.9	20.5	15.5
P/BV	7.8	6.7	5.8	4.4	3.9	3.3
Dividend yield (%)	0.6	0.6	0.6	0.6	0.8	1.1
EV/Sales	7.3	6.4	5.3	4.8	4.3	3.7
EV/EBITDA	36.6	41.0	27.5	24.4	21.4	16.4
EV / Total Assets	7.3	5.8	4.8	4.3	3.7	3.2
Per Share Data (₹)						
EPS (Basic)	8.6	9.0	9.9	13.5	13.0	17.6
EPS (fully diluted)	8.6	9.0	9.9	13.5	13.0	17.6
Cash EPS	9.9	10.5	11.9	15.5	15.8	20.9
DPS	2.0	2.0	2.0	2.0	2.6	3.5
Book Value	41.6	48.3	55.9	73.6	83.6	97.1
Dupont Analysis						
EBIT margin	17.0	12.7	16.1	16.8	16.6	18.7
Tax retention ratio	82.7	83.7	86.1	81.6	82.0	84.4
Asset turnover (x)	1.2	1.1	1.1	1.0	1.0	1.0
ROIC (Post-tax)	17.4	11.6	14.8	13.5	13.0	15.5
Cost of Debt (Post Tax)	1.9	2.9	3.8	4.0	2.5	2.5
Leverage (x)	0.1	0.1	0.2	0.1	(0.0)	(0.0)
Operating ROE	19.0	12.2	16.6	14.4	12.9	15.4
Returns (%)						
ROCE (Pre-tax)	19.7	12.9	16.1	15.6	15.3	17.5
Angel ROIC (Pre-tax)	20.9	13.8	17.4	17.3	16.9	18.8
ROE	25.6	20.1	24.8	19.2	16.6	19.5
Turnover ratios (x)						
Asset Turnover (Gross Block)	2.3	2.1	2.1	2.0	1.9	1.8
Inventory / Sales (days)	99	91	88	94	97	98
Receivables (days)	98	105	114	111	103	104
Payables (days)	45	45	45	54	57	50
WC cycle (ex-cash) (days)	207	179	186	196	197	198
Solvency ratios (x)						
Net debt to equity	(0.0)	0.1	0.2	(0.0)	(0.0)	(0.0)
Net debt to EBITDA	(0.0)	0.7	0.9	(0.1)	(0.0)	(0.1)
Interest Coverage (EBIT / Int.)	84.1	45.0	24.2	39.2	-	-

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Disclosure of Interest Statement	Cipla
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors.

Ratings (Returns):	Buy (> 15%)	Accumulate (5% to 15%)	Neutral (-5 to 5%)
	Reduce (-5% to 15%)	Sell (< -15%)	