Sharekhan
by BNP PARIBAS

Cipla

Steady earnings growth

Sector: Pharmaceuticals

Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 472**	
Price Target: **Rs. 540**	↑

↑ Upgrade ↔ No change ↓ Downgrade

Company details

Market cap:	Rs. 38,023 cr
52-week high/low:	Rs. 586/390
NSE volume: (No of shares)	24 lakh
BSE code:	500087
NSE code:	CIPLA
Sharekhan code:	CIPLA
Free float: (No of shares)	51.0 cr

Shareholding (%)

Promoters	36.7
FII	25.0
DII	17.6
Others	20.8

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	14.9	-3.9	-14.2	-8.9
Relative to Sensex	6.9	-12.3	-18.9	-22.1

Sharekhan Research, Bloomberg

Cipla reported a strong set of numbers for Q2FY2020. Topline grew by 10% y-o-y to Rs 4,396 cr, marginally ahead of estimates. Operating margin (OPM) expanded sharply by 320 bps y-o-y to 20.7%, ahead of our estimates. Operating profit grew impressively by 30% y-o-y to 910 cr. Adjusted PAT at Rs 480 cr grew 31% y-o-y, comfortably beating our estimates. The management has pointed that the concerns around re-alignment of distributors for the domestic business have been resolved. In Q3FY2020, business is expected to normalise as momentum would improve. New launches lined up by the company across geographies in the near to medium term would boost revenue. We expect Cipla's topline and PAT to clock a CAGR of 11% and 25%, respectively, over FY2019-FY2022. Also, the management has submitted its responses to the observations in Form-483 issued by the US-FDA for Cipla's Goa plant. The US FDA's reply is awaited.

Key positives

- Despite sharp price erosion in gSensipar, OPM expanded 320 bps y-o-y to 20.7%. Strong acute season, market share gains in the chronic segment and a revival in trade generics led to OPM expansion.
- Operating profit grew by 30% y-o-y while the adjusted PAT increased by 31% y-o-y.
- Cipla had taken a loan of $550 million for the Invagen acquisition. Of this, the company repaid $110 million in Q2FY2020, a year ahead of schedule

Key negatives

- Higher price erosion in generics in the US.
- Revenues from EMs and APIs declined by 4.4% and 8.7%, y-o-y respectively for the quarter.

Our Call

Valuation - Maintain Buy with revised PT of Rs. 540: Cipla has corrected by ~20% from its highs and is currently trading at 13x its FY2022E earnings. The concerns in the domestic business in Q1FY20 due to re-alignment of distributors have been completely resolved and the business is expected to normalise in Q3FY20. In the US, a strong set of product and launches would be key growth drivers. Given better–than-estimated results in Q2FY20, we have tweaked our earnings estimates for FY20/FY21 and introduce FY2022 estimates in this note. We expect the company to report sales and profit CAGRs of 11% and 25%, respectively, over FY2019-FY2022E. We maintain our Buy recommendation on the stock with a revised PT of Rs. 540.

Key Risks

- Currency fluctuations could hurt exports, which form 60% of business.
- Delay in key product approvals / faster approvals for competitors
- Any regulatory changes in India or South Africa or the US could affect business.

Valuation (Consolidated) — Rs cr

Particulars	FY2018	FY2019	FY2020E	FY2021E	FY2022E
Net sales	15219.3	16362.4	17293.7	19545.9	22282.4
OPM (%)	18.6	18.9	20.3	21.1	22.0
Reported PAT	1416.6	1492.4	1920.6	2358.0	2917.0
EPS (Rs)	17.6	18.7	23.8	29.3	36.2
PER (x)	26.8	25.2	19.8	16.1	13.0
EV/Ebidta (x)	14.7	13.7	11.6	9.4	8.5
P/BV (x)	2.7	2.5	2.2	1.9	1.7
D: E	0.32	0.34	0.25	0.18	0.16
ROCE (%)	9.7	11.1	13.4	15.1	17.1
RONW (%)	11.2	10.3	11.9	12.8	13.9

Source: Company, Sharekhan Estimates

Strong results, PAT beat estimates: Cipla reported a strong set of numbers for Q2FY2020. The sales grew by 10% y-o-y to Rs 4,396 crore on the back of healthy growth across the India, US and South Africa. Topline marginally beat estimates of Rs 4,251 crore. OPM expanded sharply by 320 bps y-o-y to 20.7% and was ahead of our estimates of 18.9%. Improvement in gross margins helped OPM expand. Operating profits surged by 30% y-o-y to Rs. 910 crore, ahead of the estimated Rs. 802 crore. Tracking the strong operating performance, adjusted PAT also grew by a sturdy 31% y-o-y to Rs 480 crore, comfortably beating our estimates of Rs 419 crore.

Domestic business on a strong footing as concerns around distribution addressed: The domestic business accounts for 40% of revenue The revenues from domestic business had dropped sharply by 13% y-o-y in Q1FY2020 as domestic operations were impacted on account of realignment of distributors in trade generics, leading to deferral of sales. The management has mentioned that the issues have been fully resolved, which has resulted in a 6% y-o-y (28% sequential) growth in domestic revenues for the quarter. Going ahead, from Q3FY20 onwards, the business is expected to normalize and regain its momentum. The company has launched one new product Berok 2.0 in the respiratory space in India.

Q2FY2020 Conference call highlights

- **Regulatory updates:** Cipla's Goa plant was inspected between September 16 and 27, 2019. The inspection was a routine common good management practices (cGMP) inspection. The inspection resulted in form-483 issued to Cipla with 12 observations, with none of them relating to data integrity issues. The management has submitted its response to the observations and is awaiting reply from US-FDA.
- **India business:** The generics and branded businesses grew strongly in Q2FY20. The branded business grew by 13% y-o-y, while the chronic therapies business reported a healthy 15% growth as against the 12% market growth.
- **South African Business:** The South Africa business which includes South Africa, Sub-Saharan and global access grew by 12% y-o-y in local currency terms. Cipla's Mirren portfolio is growing strongly and is now the third- largest player in the over-the-counter (OTC) segment with a market share of 6.8%.
- **North America:** The North American market grew strongly by 26%. The company retained its share in Cinacalcet despite multiple competitors launching the product. Also, the company launched Pragbalin and Daptomycin in the US.
- **New launches & fillings:** The company aims to submit the Tramodol NDA later in the year. Also, Cipla has resumed the supplies of Plazomicin in the US. The company is expecting to file gProventil in H1FY21. Also it is aiming to file gAdvair in Q1FY21 and is looking for another filing in the respiratory space in 4QFY20.
- **Europe and Emerging markets:** Revenue from European markets grew impressively by 35% while those from the emerging markets declined by 4%.
- **Debt:** Cipla had taken a loan of $550 million for the Invagen acquisition. Of this the company has repaid $110 million in Q2FY2020, a year ahead of schedule.
- Cipla has guided for gross margins of 65-66% for FY20. R&D investments stood at Rs. 295 crore (7% of sales for Q2FY2020).

Results Rs cr

Particulars	Q2FY2020	Q2FY2019	y-o-y %	Q1FY2020	q-o-q%
Net sales + OOI	4395.8	4011.9	9.6	3989.0	10.2
Expenditure	3486.3	3309.7	5.3	3084.4	13.0
Operating profit	909.5	702.2	29.5	904.6	0.5
Other income	100.5	132.6	-24.2	78.4	28.3
EBIDTA	1010.0	834.8	21.0	983.0	2.7
Interest	46.1	44.4	3.8	52.1	-11.6
Depreciation	283.0	281.9	0.4	268.0	5.6
PBT	681.0	508.5	33.9	662.9	2.7
Tax	200.6	142.4	40.8	192.2	4.3
Adjusted PAT	480.4	366.1	31.2	470.7	2.1
Excpetional Item	-2.8	-0.3		-23.8	
Reported PAT	477.7	365.8	30.6	446.9	6.9
Adj. EPS (Rs)	6.0	4.6	31.2	5.9	2.1
			bps		bps
OPM (%)	20.7	17.5	319	22.7	-199

Source: Company; Sharekhan Research

Geographical Sales Break Up – Quarterly Rs cr

Geography	Q2FY2020	Q2FY2019	y-o-y %	Q1FY2020	q-o-q %
India (Rx+Gx)	1745	1644	6.1	1355	28.8
North America	953	758	25.7	1119	-14.8
SAGA	740	754	-1.9	691	7.1
EM	451	472	-4.4	279	61.6
Europe	190	141	34.8	201	-5.5
API	157	172	-8.7	182	-13.7
Others	159	71	123.9	160	-0.6
Total	**4395.0**	**4012.0**	**9.5**	**3987.0**	**10.2**

Source: Company

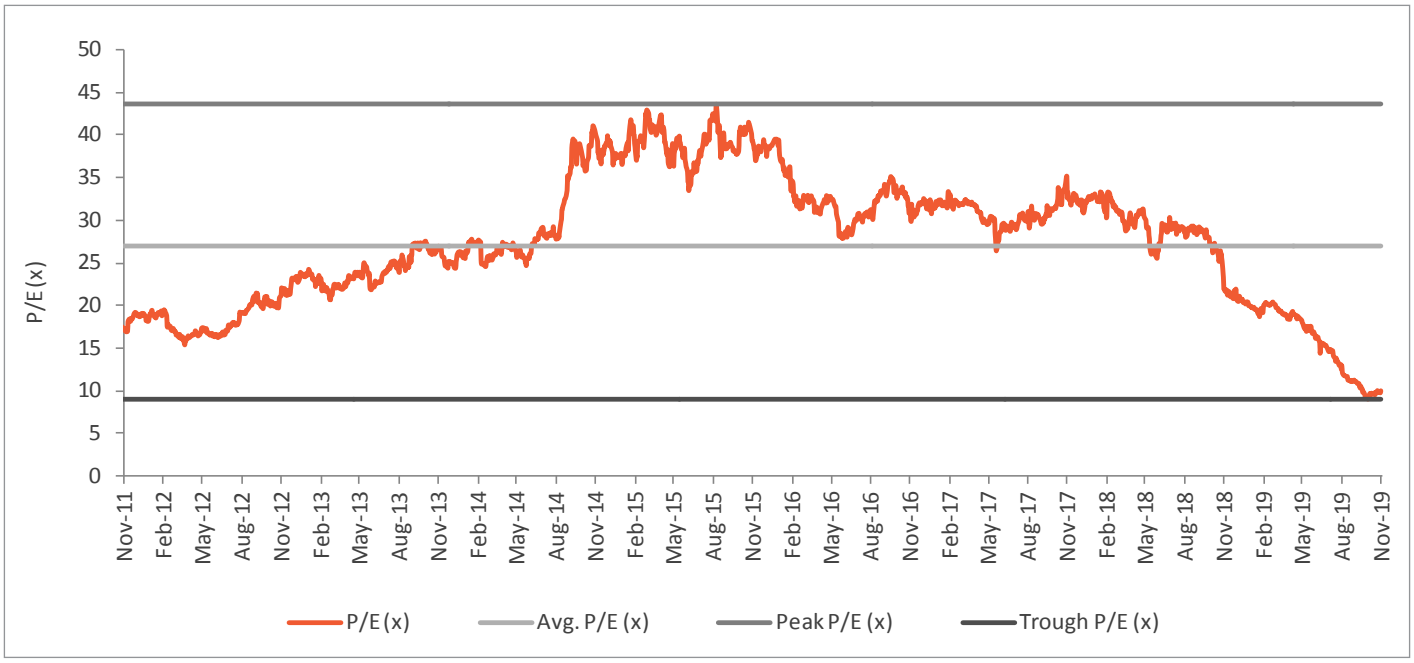
Outlook

The domestic business is expected to normalise and it is likely to regain momentum in Q3FY20. Issues around the re-alignment of distributors have been resolved, which augurs well for the company. Also the company's US business is likely to gain traction. The company has guided for steady gross margins of 65-66% for FY20.

Valuation

Maintain Buy with revised PT of Rs. 540: Cipla has corrected by ~20% from its highs and is currently trading at 13x its FY2022E earnings. The concerns in the domestic business in Q1FY20 due to re-alignment of distributors have been completely resolved and the business is expected to normalise in Q3FY20. In the US, a strong set of product and launches would be key growth drivers. Given better–than-estimated results in Q2FY20, we have tweaked our earnings estimates for FY20/FY21 and introduce FY2022 estimates in this note. We expect the company to report sales and profit CAGRs of 11% and 25%, respectively, over FY2019-FY2022E. We maintain our Buy recommendation on the stock with a revised PT of Rs. 540.

One-year forward P/E (x) Band



Source: Sharekhan Research

About company

Cipla is a global pharmaceutical company with a geographically diversified presence and products registered in more than 170 countries. Indian branded formulations account for more than 40% of business and Cipla is among the top three players in the market. In the past, the company believed in the partnership model for international markets. However, in the past three years, the company is undergoing a strategic shift and has started setting up its own front-end divisions. Cipla is also a well-known global player in inhalers and anti-retrovirals. Going forward, the company is planning to launch combination inhalers in larger markets such as the US and EU and is also setting up own front-ends to drive growth.

Investment theme

Cipla banks on its branded business in India and South Africa, both of which together contribute ~60% of business. Despite the challenging environment in the US and Europe, Cipla is insulated from it as it has limited exposure to these markets. The India and South Africa businesses are cash cows, the returns of which it invests in developed markets to gain scale. Moreover, an improving product mix, operational efficiencies and optimal capacity utilisation will help the company expand margins significantly in the next two years.

Key Risks

- Currency fluctuations could hurt exports, which form 60% of business.
- Delay in key product approvals / faster approvals for competitors
- Any regulatory changes in India or South Africa or the US could affect business.

Additional Data

Key management personnel

Mr. Umang Vohra	Managing Director & Global Chief Executive Officer
Dr. R. Ananthanarayanan	Global Chief Operating Officer
Mr. Kedar Upadhye	Global Chief Financial Officer
Dr. Raju Mistry	Global Chief People Officer
Dr. Ranjana Pathak	President - Global Quality, Medical Affairs & Pharmacovigilance
Ms. Geena Malhotra	President &Global Head – Mfg Operations & Respiratory Centre of Excellence

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Hamied Yusuf K	20.3
2	ICICI Prudential Asset Management	5.7
3	Hamied Mustafa Kamil	4.3
4	Life Insurance Corp of India	3.5
5	Commonwealth Bank of Australia	3.1
6	HDFC Asset Management Co Ltd	2.6
7	Vaziralli Samina	2.2
8	AHMED SOPHIE	1.9
9	BlackRock Inc	1.5
10	Reliance Capital Trustee Co Ltd	1.5

Source: Bloomberg

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;