Cadila Healthcare

Corrected but not ripe for investment

HOLD

CMP	`338
Target Price	'370
Investment Period	**12 Months**

Cadila Healthcare (Cadila) is on the largest Pharmaceuticals player both in US & Indian markets. However, over the last few years, the company has been going through tough times both in USA & Indian markets. While the Indian formulation market has been under pressure on back of the pricing norms & GST implementation, USA market has witnessed tougher times by Cadila Healthcare, on back of its Moriya facility coming under USFDA warning letter. However, since then the company has taken steps to mitigate the risk in its business. The stock has given a correction, to account for the high business risk; however, it still provides very little comfort for investors. **We recommend a Hold rating on the stock.**

Growth to be driven by Domestic Business: Cadila's exports contributed around 59% to its FY2018 sales. Company has established a formidable presence in the developed markets of US, Europe (France and Spain) and ROW. USA exports are expected to post a CAGR of 1.4% over FY2018-21E, driven by new product launches and more focused launches in injectable, Transdermal and Specialty segments. Overall, we have built in an export sales CAGR of 2.3% over FY2018-21E. In the domestic market, it plans to perk-up its productivity levels, along with aggressively launching new products, which will keep the momentum steady. We have conservatively forecasted the formulation business to post a CAGR of 9.5% CAGR during the FY2018-21E. Apart from Domestic formulation business, the company has a strong consumer division, which contributed ~4% of sales in FY2018. After the Heinz acquisition, company's wellness segment will contribute around 12% by FY2020. Over FY2018-21E, the segment is expected to post a CAGR of 62.0% during the period.

Valuations & Outlook: Over FY2018-21E, the company expects to post a sales and net profit CAGR of 9.1% and a flat growth during FY2018-21E respectively. Company's stock has witnessed a correction & however given the challenges, at current valuations the stock provides very little upside. **Hence, we have factored in the same to recommend a Hold.**

Key financials (Consolidated)

Y/E March (` cr)	FY2018	FY2019E	FY2020E	FY2021E
Net sales	**11,599**	**12,624**	**14,063**	**15,055**
% chg	25.8	8.8	11.4	7.0
Net profit	**1,776**	**1,773**	**1,708**	**1,653**
% chg	19.4	(0.2)	(3.6)	(3.3)
EBITDA margin (%)	21.8	20.4	19.1	17.9
EPS (`)	**17.3**	**17.3**	**16.7**	**16.1**
P/E (x)	19.5	19.5	20.2	20.9
P/BV (x)	4.0	3.5	3.1	2.8
RoE (%)	22.6	18.9	16.1	14.0
RoCE (%)	15.6	12.9	11.7	10.6
EV/Sales (x)	3.3	3.2	2.9	2.6
EV/EBITDA (x)	15.1	15.6	15.0	14.3

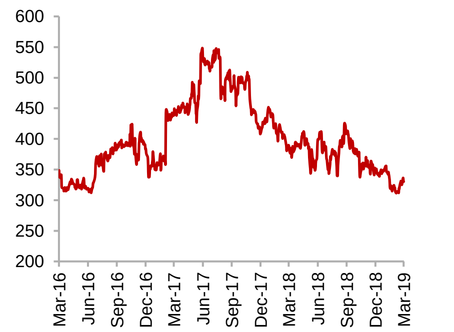
Source: Company, Angel Research; Note: CMP as of March 26, 2019

Stock Info	
Sector	Pharmaceuticals
Market Cap (` cr)	34,341
Net Debt (` cr)	4,017
Beta	1.0
52 Week High / Low	432/306
Avg. Daily Volume	45,560
Face Value (`)	1
BSE Sensex	38,233
Nifty	11,483
Reuters Code	CADI.BO
Bloomberg Code	CDH.IN

Shareholding Pattern (%)	
Promoters	74.8
MF / Banks / Indian FIs	10.6
FII / NRIs / OCBs	8.4
Indian Public / Others	6.2

Abs.(%)	3m	1yr	3yr
Sensex	6.8	15.6	53.1
Cadila Healthcare	(1.0)	(13.9)	5.2

3-Year Daily Price Chart



Source: Company, Angel Research

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Exports; expected to be lackluster

Cadila has a two-fold focus on exports (which contributed around 59% to its FY2018 top-line), wherein it is targeting developed as well as emerging markets. The company has established a formidable presence in the developed markets of US, Europe (France and Spain) and Japan. In the US, the company achieved critical scale of `5,834cr (US$900mn) on the sales front in FY2018. The growth in exports to the USA along with other regions like ROW would be driven by new product launches, going forward.

USA sales visibility better than earlier; but product concentration still high

USA is the key export market for the company, contributing 50% of overall sales. The company registered a CAGR growth of 28% during FY2014-2018 in the region. It is the 8 th largest generic pharmaceutical company in US by Prescription Share & company's 65% of portfolio occupy Top 3 position in the US generic prescription market (IQVIA SMART NPA Generic TRx MAT October 2018). In addition, the company is amongst the company with largest and diversify product pipeline for the USA market. As on 31st Dec'2018, the company had overall 352 ANDA's with around 215 ANDA is pending approval. With around 15-20 ANDA's expected to be approved annually, implies the region can grow easily at 15-20% CAGR for next 4-5 years.

Cadila Healthcare in spite of being one of the top ANDA filer in the USA market (third, after Sun Pharma & Aurobindo Pharma), had seen a rough patch in USA markets; when its biggest facility Moriya plant went through USFDA inspection and import alert. The sales from that plant contributed around 60% of its USA sales then. However, after FY2017; the situation improved for the company as the plant got the clean chit. Thus, since FY2018, USA sales of the company has improved on back of niche opportunities and new product launches. Going into future, company in the near future i.e FY2019/2020, should witness a slew of launches. For FY2019/2020, company is expected to launch 50 and 40 products respectively. However, given that most of its niche launches would face competitive pressures & new launches, overall the USA sales is unlikely to witness significant growth. In terms of de-risking its filings and reducing the USFDA event risk, the company since its experience with Moriya plant has built further manufacturing facilities like Ahmedabad SEZ, Baddi & has acquired the Windlas facility. As per Management now, Moriya accounts only for 18% of pending approvals.

In terms, of nature of fillings, the company has diversified filings across the therapeutic segments. Key therapeutic segments which will drive its growth in USA over next 3-4 years, would be injectable, Transdermal and Specialty. While the company has products being developed in-house for the former two categories, in specialty the company as acquired Sentynl Therapeutics, which had sales of US$70mn in FY2018, contributing 10% of USA sales. The profitability of the company is very high with net margins of 37%. As per Specialty segment, company plans to expand the same lead by acquisition strategy. Overall USA exports are expected to post a CAGR of 1.4% over FY2018-21E. This is mainly on back of the base effect of FY2018, where key niche opportunities like gLiada, gAsacol HD and to some extent by gTamiflu capsules. These products according to us would have contributed around ~40% of its sales in FY2018. This is the main reason, that Cadila HealthCare's USA business will report flat sales inspite of new launches. Going forward, the growth In USA is highly dependent upon the new product launches. Thus, while company has taken steps to diversify its fillings facility and segment wise to arrest any major impact on USA sales. Excluding the niche opportunities, the USA business is expected to register a growth of 10.0% during FY2018-21E.

ROW exports to be driven by Vaccines & biologicals; Europe still to pickup

Apart from USA, company has good presence in Europe & ROW (Emerging Markets & Brazil). Historically over FY2014-2017, the company saw European sales dip at a CAGR of 12.4%, while Brazil & Emerging markets during the period posted a CAGR of 1.3% and 11.2% respectively. Going forward, for ROW, the company has chalked out a strategy to supply Biotech & Vaccines to the key growth drivers in the region. Company expects these two product categories to register sales of US$ 200mn over next 4-5 years. Going into FY2018-21E, we expect regions like Brazil & Emerging markets to grow at a CAGR of 9.0% respectively. European region, we believe will remain lackluster. Overall, we have built in an export sales CAGR of 2.3% over FY2018-21E.

Domestic portfolio; Focusing on growth levers

Cadila is the fourth largest player in the domestic market with sales of about `3,332cr in FY2018; the domestic market contributed ~29% to its top-line. The company enjoys a leadership position in the CVS, GI, women healthcare and respiratory segments, and has a sales force of 6,000+ Field Force. Over FY2014-2018, Formulation sales grew by 7.8% CAGR, which aided a 7.6% CAGR in overall domestic sales. Cadila Healthcare, historically grown lower than the Indian Industry growth rate of 11-12% CAGR during the period.

One of prime reason behind the same has been high concentration of old mature products, which still forms 22-25% of the domestic formulation business. This has also kept the Cadila's field productivity low at around 40-45lacs. Going forward, company plans to perk-up its productivity levels and expects it to reach 60lacs in next few years. Along with this company has been aggressively launching new products, which will keep the momentum steady. We have conservatively forecasted the formulation business to post a CAGR of 9.5% CAGR during the FY2018-21E.

Apart from Domestic formulation business, the company has a strong consumer division through its stake in Zydus Wellness, which has premium brands such as *Sugarfree*, *Everyuth* and *Nutralite* under its umbrella. This segment, which contributed ~4% of sales in FY2018, registering a growth of 3.4% during FY2014-2018. However, after the Heinz acquisition during 3QFY2019; company's wellness segment will contribute around 12% by FY2020.

With this Cadila gets Glucon-D, Nycil and Sampriti Ghee (Global rights), Complan (rights for India, Bangladesh, Nepal and those countries where seller has IP rights). Amongst the brands to be, acquired Glucon-D is the largest one and both Glucon-D and Nycil have been growing faster than the market growth rate. Heinz India has sales of `11,.500cr with EBITDA of `225cr for 12months of June'2018. This is largely domestic sales with small exports. The company has been acquired at the cost of `4,595cr to be funded in cash along with a combination of debt and equity. Overall, the management indicated that transaction is likely to be funded 2/3rd by equity and the balance 1/3rd by debt (has an interest cost of 9.4%). Company plans further infusion of around `1000-`1200cr.

Over FY2018-21E, the segment is expected to post a CAGR of 62.0% during the period, contributing 12% of overall sales by FY2020. Overall, FY2018-21E, we expect the domestic segment to grow at a CAGR of 19.1%.

Valuations & Outlook

Cadila Healthcare has been one of the steady companies in the Indian Pharmaceutical Industry; in spite of all the challenges. Over FY2011-18E, the company has witnessed a sales growth of 14.6%; while net profit has registered a growth of 14.0%. EBDITA margins of the company has been steady at around 18-19%.

Going forward, as company moves along with the iIndustry into the next leg of the transition; where more complex and specialty products along with normal generic–generic products will dominate the growth drivers of most of the companies. Thus M&A along with investments in R&D could witness a pump-up. Hence, we are going selective in the space; given these product categories are going to be complex. In addition, given the regulatory risks involved in the business from both USA markets & domestic markets, we expect few companies to cruise through the new challenges.

Cadila Healthcare has built in blocks to make that transition smooth, by putting a strategy to diversifying its USA business in terms of both fillings (plant-wise) & product launches. Hence, over FY2018-21E, the company expects to post a sales and net profit CAGR of 9.1% and flattish growth during the FY2018-21E respectively. However, on negative side the ROIC of the company is around 17%; with D/E of 0.6xFY2019E. Given that, the generic pharmaceutical business is a price sensitive business & requires a lot of discipline for the players to deliver consistently over a period. Cadila Healthcare has been one of such players and future pharmaceuticals business will demand more R&D expenses & strong balance sheets. While Cadila Healthcare, scores over its peers in many factors like diversified big ANDA pipeline, disciplined approach to R&D investments, strong control on expenses, its' domestic business lacks its peers in terms of growth and other key parameters. Further, its concentration in its key markets like USA & Indian is a risk. This we have witnessed in the stock performance of the company. Thus while, the dip has provided some relief, we believe at this juncture the stock given the challenges, at current valuations provides very little upside. **Hence, we have factored in the same to recommend a Hold.**

Company Background

Zydus Cadila, a leading Indian Pharmaceutical company is a fully integrated, global healthcare provider. With in-depth domain expertise in the field of healthcare, it has strong capabilities across the spectrum of the pharmaceutical value chain. From formulations to active pharmaceutical ingredients and animal healthcare products to wellness products, Zydus has earned a reputation amongst Indian pharmaceutical companies for providing comprehensive and complete healthcare solutions. Having already achieved the US$1bn sales mark in 2011, the company aims to be a research-driven pharmaceutical company by 2020.

Profit & Loss statement (Consolidated)

Y/E March (` cr)	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Gross sales	**9,262**	**9,416**	**11,631**	**12,658**	**14,109**	**15,105**
Less: Excise duty	190	196	32	34	46	50
Net sales	**9,072**	**9,220**	**11,599**	**12,624**	**14,063**	**15,055**
Other operating income	355	210	306	406	406	406
Total operating income	**9,427**	**9,430**	**11,905**	**13,030**	**14,469**	**15,460**
% chg	*9.0*	*0.0*	*26.3*	*9.5*	*11.0*	*6.8*
Total expenditure	**7,099**	**7,526**	**9,076**	**10,047**	**11,380**	**12,354**
Net raw materials	3,096	3,445	4,437	4,829	5,379	5,721
Other mfg costs	570	579	729	631	703	753
Personnel	1,262	1,500	1,855	2,188	2,626	3,020
R&D Expenses	726	754	942	1,010	1,125	1,204
Other	1,446	1,248	1,114	1,389	1,547	1,656
EBITDA	**1,973**	**1,694**	**2,523**	**2,577**	**2,683**	**2,701**
% chg	23.2	(14.2)	49.0	2.2	4.1	0.7
(% of Net Sales)	**21.7**	**18.4**	**21.8**	**20.4**	**19.1**	**17.9**
Depreciation& amortization	292	375	539	690	770	850
EBIT	1,681	1,319	1,984	1,887	1,913	1,850
% chg	27.9	(21.5)	50.5	-4.9	1.4	-3.2
(% of Net Sales)	18.5	14.3	17.1	14.9	13.6	12.3
Interest & other charges	53	45	91	167	198	210
Other income	116	129	113	200	120	120
(% of PBT)	6	8	5	9	5	6
Recurring PBT	2,099	1,612	2,312	2,326	2,240	2,166
% chg	44.1	(23.2)	43.4	0.6	(3.7)	(3.3)
Extraordinary expense/(Inc.)	2	-	-	0	0	0
PBT (reported)	2,099	1,612	2,312	2,326	2,240	2,166
Tax	177.4	128.9	564.4	581.5	560.0	541.5
(% of PBT)	8.5	8.0	24.4	25.0	25.0	25.0
PAT (reported)	1,921	1,483	1,747	1,744	1,680	1,624
Less: Minority interest (MI)	30.0	29.1	(28.2)	(28.2)	(28.2)	(28.2)
PAT after MI (reported)	1,934	1,488	1,776	1,773	1,708	1,653
ADJ. PAT	**1,936**	**1,488**	**1,776**	**1,773**	**1,708**	**1,653**
% chg	67.0	(23.2)	19.4	(0.2)	(3.6)	(3.3)
Basic EPS (`)	**18.9**	**14.5**	**17.3**	**17.3**	**16.7**	**16.1**

Balance Sheet (Consolidated)

Y/E March (` cr)	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
SOURCES OF FUNDS						
Equity share capital	102	102	102	102	102	102
Reserves & Surplus	5,597	6,858	8,642	9,896	11,105	12,274
Shareholders funds	**5,699**	**6,960**	**8,746**	**10,001**	**11,210**	**12,381**
Minority interest	**135**	**156**	**191**	**163**	**135**	**106**
Total loans	2,107	4,945	5,113	6,000	6,000	6,000
Other Long Term Liabilities	61	45	64	47	48	49
Long Term Provisions	97	169	156	156	156	156
Deferred tax liability	(318)	(401)	(643)	(643)	(643)	(643)
Total liabilities	**7,782**	**11,875**	**13,626**	**15,724**	**16,906**	**18,049**
APPLICATION OF FUNDS						
Gross block	4,786	5,436	8,131	9,131	10,131	11,131
Less: Acc. depreciation	2,120	2,495	3,033	3,724	4,494	5,345
Net block	**2,666**	**3,942**	**5,097**	**5,407**	**5,636**	**5,786**
Capital Work-in-Progress	892	892	1,527	1,527	1,527	1,527
Goodwill	1,141	2,465	1,385	1,385	1,385	1,385
Investments	**416**	**435**	**746**	**3,375**	**3,845**	**3,124**
Long Term Loans and Adv.	836	997	460	460	460	460
Current assets	4,081	5,973	7,926	7,395	8,314	10,329
Cash	639	1,544	1,315	160	129	1,607
Loans & advances	335	336	337	407	578	579
Other	3,108	4,094	6,274	6,828	7,607	8,143
Current liabilities	**2,250**	**2,829**	**3,515**	**3,825**	**4,261**	**4,562**
Net Current assets	**1,831**	**3,144**	**4,411**	**3,570**	**4,052**	**5,767**
Mis. Exp. not written off	-	-	-	-	-	
Total assets	**7,782**	**11,875**	**13,626**	**15,724**	**16,906**	**18,049**

Cash Flow Statement (Consolidated)

Y/E March (` cr)	FY2016	FY2017	FY2018	FY2019	FY2020E	FY2021E
Profit before tax	2,099	1,612	2,312	2,326	2,240	2,166
Depreciation	292	375	539	690	770	850
(Inc)/Dec in Working Cap.	(37)	(570)	(957)	(314)	(513)	(237)
Less: Other income	116	129	113	200	120	120
Direct taxes paid	177	129	564	581	560	541
Cash Flow from Operations	**2,061**	**1,160**	**1,216**	**1,921**	**1,817**	**2,118**
(Inc.)/Dec.in Fixed Assets	(433)	(650)	(3,331)	(1,000)	(1,000)	(1,000)
(Inc.)/Dec. in Investments	(262)	(19)	(311)	(2,629)	(470)	721
Other income	116	129	113	200	120	120
Cash Flow from Investing	**(579)**	**(540)**	**(3,529)**	**(3,429)**	**(1,350)**	**(159)**
Issue of Equity	-	-	-	-	-	-
Inc./(Dec.) in loans	(222)	2,894	173	870	1	1
Dividend Paid (Incl. Tax)	(572)	(327)	(419)	(518)	(500)	(483)
Others	(589)	(2,431)	1,804	479	1	1
Cash Flow from Financing	**(1,383)**	**136**	**1,557**	**831**	**(498)**	**(482)**
Inc./(Dec.) in Cash	99	756	(756)	(677)	(31)	1,477
Opening Cash balances	**738**	**837**	**1,593**	**837**	**160**	**129**
Closing Cash balances	**837**	**1,593**	**837**	**160**	**129**	**1,607**

Key Ratios

Y/E March	FY2016	FY2017	FY2018	FY2019	FY2020E	FY2021E
Valuation Ratio (x)						
P/E (on FDEPS)	17.9	23.2	19.5	19.5	20.2	20.9
P/CEPS	15.5	18.5	14.9	14.0	13.9	13.8
P/BV	6.1	5.0	4.0	3.5	3.1	2.8
Dividend yield (%)	0.9	1.0	1.0	1.3	1.2	1.2
EV/Sales	3.9	4.0	3.3	3.2	2.9	2.6
EV/EBITDA	17.9	21.9	15.1	15.6	15.0	14.3
EV / Total Assets	4.5	3.1	2.8	2.5	2.4	2.1
Per Share Data (`)						
EPS (Basic)	18.9	14.5	17.3	17.3	16.7	16.1
EPS (fully diluted)	18.9	14.5	17.3	17.3	16.7	16.1
Cash EPS	21.8	18.2	22.7	24.1	24.3	24.5
DPS	3.2	3.5	3.5	4.3	4.2	4.0
Book Value	55.7	68.0	85.4	97.7	109.5	120.9
Dupont Analysis						
EBIT margin	18.5	14.3	17.1	14.9	13.6	12.3
Tax retention ratio	91.5	92.0	75.6	75.0	75.0	75.0
Asset turnover (x)	1.4	1.1	1.1	0.9	0.9	0.9
ROIC (Post-tax)	23.8	14.2	13.6	10.5	9.1	8.6
Cost of Debt (Post Tax)	2.2	1.2	1.4	2.3	2.5	2.6
Leverage (x)	0.3	0.4	0.5	0.5	0.6	0.4
Operating ROE	30.8	19.1	19.2	14.7	12.8	11.2
Returns (%)						
ROCE (Pre-tax)	22.8	13.4	15.6	12.9	11.7	10.6
Angel ROIC (Pre-tax)	34.4	21.8	24.2	17.1	14.4	13.5
ROE	38.9	23.5	22.6	18.9	16.1	14.0
Turnover ratios (x)						
Asset Turnover (Gr. Block)	2.1	1.8	1.8	1.5	1.5	1.5
Inventory / Sales (days)	56	61	64	54	55	63
Receivables (days)	65	78	84	71	72	84
Payables (days)	83	105	112	61	60	59
WC (ex-cash) (days)	49	54	72	91	92	95
Solvency ratios (x)						
Net debt to equity	0.3	0.5	0.4	0.6	0.5	0.4
Net debt to EBITDA	0.7	2.0	1.5	2.3	2.2	1.6
Int. Coverage (EBIT / Int.)	31.8	29.3	21.8	11.3	9.7	8.8

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1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):	*Buy (> 15%)*	*Accumulate (5% to 15%)* *Reduce (-5% to -15%)*	*Neutral (-5 to 5%)* *Sell (< -15)*