Cipla

Performance Highlights

Y/E March (₹ cr)	2QFY2017	1QFY2017	% chg qoq	2QFY2016	% chg yoy
Net sales	3,672	3,500	4.9	3,379	8.7
Other income	106	119	(10.7)	107	(0.1)
Gross profit	2,342	2,129	10.0	2,171	7.9
Operating profit	602	517	16.3bp	710	(15.3)bp
Adj. Net profit	354	365	(3.0)	543	(34.7)

Source: Company, Angel Research

Cipla posted numbers lower than expected for 2QFY2017. The company posted sales of ₹3,672cr vs. ₹3,737cr expected, registering a yoy growth of 8.7%, mainly aided by domestic formulations. Domestic formulation (₹1,522cr) grew by 11.3% yoy, while exports (₹2150cr) grew by 7.5% yoy. On the operating front, the EBITDA margin came in at 16.4% vs. 16.5% expected vs. 21.0% in 2QFY2016, mainly on back of base effect. Consequently, the Adj. PAT came in at ₹354cr vs. ₹498cr expected vs. ₹543cr in 2QFY2016, a yoy de-growth of 34.7%. **We maintain our Reduce rating on the stock.**

Results much lower than our expectations: Cipla posted numbers lower than expected during the quarter. The company posted sales of ₹3672cr vs. ₹3,737cr expected, registering a yoy growth of 8.7%, mainly aided by domestic formulations. Domestic formulation (₹1,522cr) grew by 11.3% yoy, while exports (₹2150cr) grew by 7.5% yoy. On the operating front, the EBITDA margin came in at 16.4% vs. 16.5% expected vs. 21.0% in 2QFY2016, mainly on back of base effect. Consequently, the Adj. PAT came in at ₹354cr vs. ₹498cr expected vs. `543cr in 2QFY2016, a yoy de-growth of 34.7%.

Outlook and valuation: We expect the company to post a CAGR of 16.3% in net sales to ₹18,089cr and EPS to record a CAGR of 20.4% to ₹27.2cr over FY2016–18E. **We reiterate our Reduce stance on the stock.**

Key financials (Consolidated)

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E
Net sales	11,681	13,372	15,378	18,089
% chg	19.8	14.5	15.0	17.6
Adj. Net profit	1,578	1,506	1,736	2,185
% chg	13.6	(4.5)	15.3	25.9
EPS (₹)	19.6	18.8	21.6	27.2
EBITDA margin (%)	17.7	16.4	17.4	18.4
P/E (x)	23.8	24.9	21.6	17.2
RoE (%)	15.1	13.3	13.7	15.2
RoCE (%)	12.9	10.7	11.1	13.5
P/BV (x)	3.5	3.2	2.8	2.4
EV/Sales (x)	3.3	3.1	2.7	2.2
EV/EBITDA (x)	18.6	18.8	15.3	12.0

Source: Company, Angel Research; Note: CMP as of November 10, 2016

REDUCE

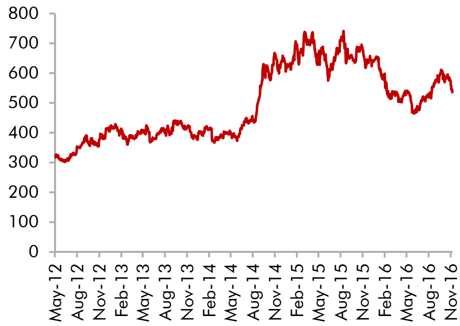
CMP	₹564
Target Price	₹490
Investment Period	-

Stock Info	
Sector	Pharmaceutical
Market Cap (₹ cr)	45,378
Net Debt (₹ cr)	563
Beta	0.6
52 Week High / Low	660/458
Avg. Daily Volume	169,642
Face Value (₹)	2
BSE Sensex	27,518
Nifty	8,750
Reuters Code	CIPL.BO
Bloomberg Code	CIPLA@IN

Shareholding Pattern (%)	
Promoters	36.7
MF / Banks / Indian FIs	20.3
FII / NRIs / OCBs	23.9
Indian Public / Others	19.1

Abs. (%)	3m	1yr	3yr
Sensex	(0.9)	6.9	33.2
Cipla	7.8	(12.0)	(12.8)

3-Year Daily Price Chart



Source: Company, Angel Research

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Exhibit 1: 2QFY2017 (Consolidated) performance

Y/E March (₹ cr)	2QFY2017	1QFY2017	% chg QoQ	2QFY2016	% chg yoy	1HFY2017	1HFY2016	% chg yoy
Net sales	**3,672**	**3,500**	***4.9***	**3,379**	***8.7***	**7,228**	**7,171**	***0.8***
Other income	106.4	119.1	*(10.7)*	106.5	*(0.1)*	225.5	234.5	*(3.8)*
Total income	**3,778**	**3,619**	***4.4***	**3,486**	***8.4***	**7,453**	**7,406**	***0.6***
Gross profit	2342	2129	10.0	2171	*7.9*	4527	4719	*(4.1)*
Gross margin	**63.8**	**60.8**		**64.2**		**62.6**	**65.8**	
Operating profit	602	517	*16.3*	710	*(15.3)*	1119	1687	*(33.7)*
OPM (%)	**16.4**	**14.8**		**21.0**		**15.5**	**23.5**	
Interest	35.2	31.3	*12.2*	63.6	*(44.8)*	67	127	*(47.7)*
Depreciation	229	161	*42.5*	158	*44.7*	433	308	*40.7*
PBT	444	444	*(0.1)*	595	*(25.4)*	845	1487	*(43.2)*
Provision for taxation	72	71	*1.5*	40	*79.5*	127	282	*(54.9)*
PAT before extra-ordinary item	**372**	**374**	***(0.5)***	**555**	***(33.0)***	**718**	**1205**	***(40.4)***
Share of Profit /(loss) of asso.	(17)	(8)		(3)		(24)	(12)	
Extra-ordinary items/(income)	0	0		9		0	0	
PAT after extra-ordinary item	**354**	**365**	***(3.0)***	**543**	***(34.7)***	**693**	**1192**	***(41.8)***
Adj. PAT	**354**	**365**	***(3.0)***	**543**	***(34.7)***	**693**	**1192**	***(41.8)***
EPS (₹)	**4.4**	**4.5**		**6.8**		**8.6**	**14.8**	

Source: Company, Angel Research

Exhibit 2: 2QFY2017 – Actual vs. Angel estimates

(₹ cr)	Actual	Estimates	*Variance*
Net sales	**3,672**	**3,737**	**(1.7)**
Other income	106	117	(8.8)
Operating profit	602	618	(2.6)
Tax	72	97	(25.7)
Net profit	**354**	**498**	**(28.8)**

Source: Company, Angel Research

Top-line growth lower than expectation

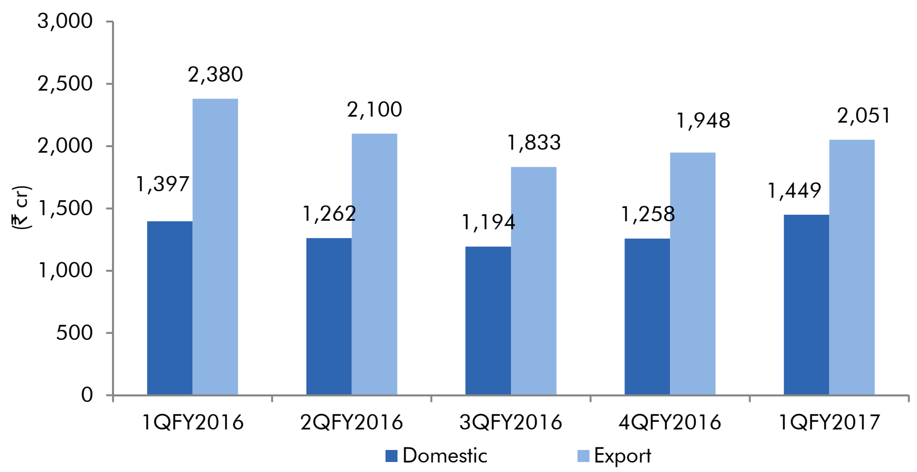
The company posted sales of ₹3672cr vs. ₹3,737cr expected, registering a yoy growth of 8.7%, mainly aided by domestic formulations. Domestic formulation (₹1,522cr) grew by 11.3% yoy, while exports (₹2150cr) grew by 7.5% yoy.

USA (US$98mn) posted a yoy de-growth of 25.8% excluding Nexium and Invagen sales; the base business posted a yoy growth of 30%+. The company was the third fastest-growing generics player in the US in 1QFY2017 and has 8 out of its 38 products ranked #1 in their respective segments. The company expects the US portfolio to deliver robust growth on the back of its strong launch pipeline (~15 launches expected in the rest of FY2017) and enhanced focus on R&D.

South Africa (ZAR905mn) registered a growth of ~22% over the last year. The company has a market share of ~5.3% in the private market and is the 3rd largest generics player in South Africa with leadership in Respiratory, CNS, and Oncology segments, where it commands a ~25-30% market share. Also, the company posted a growth of 10% yoy in tender sales vs. last year.

Emerging market sales (US$113mn) posted an overall de-growth of ~11% yoy in 1QFY2017. Direct to market (DTM) sales declined by ~13% yoy owing to forex volatility and complexity reduction initiatives, while there has been resurgence in partnership-led markets (B2B) with 15% yoy growth.

Exhibit 3: Sales Trend

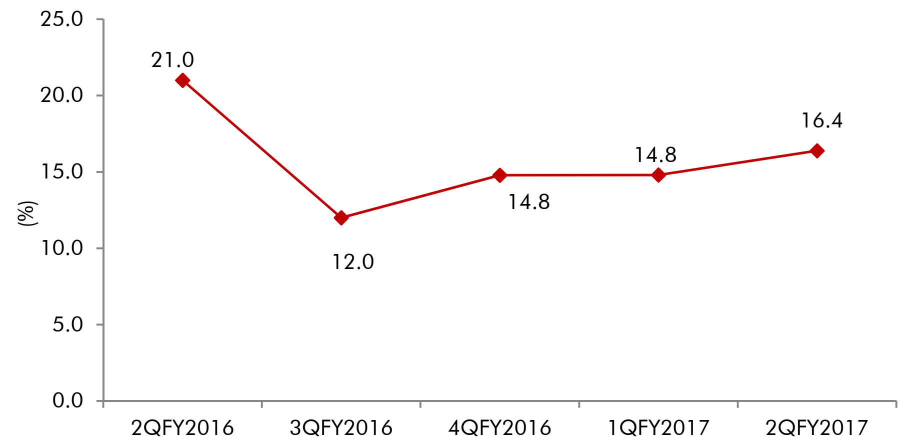


Source: Company

Operating profit margin just in line with expectation

On the operating front, the EBITDA margin came in at 16.4% vs. 16.5% expected vs. 21.0% in 2QFY2016, mainly on back of base effect. The employee expenses during the quarter came in at ₹675.3cr, a yoy growth of 57.8%; while other expenses during the quarter came in at ₹1065cr, a rise of 27.9% yoy.

Exhibit 4: OPM Trend

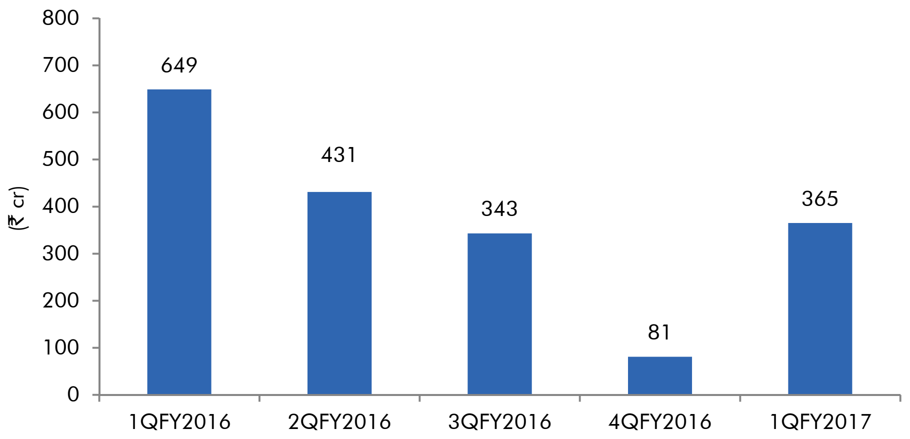


Source: Company

Net profit lower than expectation

Consequently, the Adj. PAT came in at ₹354cr vs. ₹498cr expected vs. ₹543cr in 2QFY2016, a yoy de-growth of 34.7%.

Exhibit 5: Net Profit Trend



Source: Company

Concall takeaways

- R&D as % of sales for the quarter stood at 6.6%; it is expected to be at ~8% in FY2017 as against ~6.5% in FY2016.
- In USA, the company expects to file 15 ANDAs in FY2017.
- DPCO and Fixed Dosage Combinations ban in domestic market expected to impact by ~2-3% for FY2017.

Recommendation rationale

Export segment to be the growth driver: Cipla exports to more than 180 countries, with growth coming through marketing alliances and distribution tie-ups in various markets. Exports contributed 60% to the total turnover in FY2016, with Africa, US and Latin America constituting more than ~60% of total exports. In the US, Cipla has a strong product pipeline of 168 ANDAs, out of which, 90 are approved. Another long term growth driver for the company is the launch of the CFC-free inhalers in the regulated markets. CFC-free inhalers in Europe and US address a potential market size of more than US$3bn.

During the quarter, the company strengthened its foothold in the US through the acquisition of InvaGen Pharma and Exelan Pharma. The companies added a pipeline of ~70 ANDAs of which 40 are approved (32 marketed) and 30 awaiting approval. The company is likely to add over USD250mn in FY2017. The deal is expected to conclude by December 2015. It will also provide manufacturing capabilities in the US. Overall, we expect the company's exports to grow at a CAGR of 19.1% during FY2016-18E.

Increasing penetration in the domestic market: Cipla is one of the largest players in the domestic formulation market with a market share of around 5.3%. Domestic formulations contributed 40% to the company's total turnover in FY2016. 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 7,000-8,000 employees. The company plans to increase its focus on domestic markets with new therapies such as oncology and neuro-psychiatry in the offing. The company 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. Overall, we expect the company's domestic formulation business to post a CAGR of 14.0% over FY2016-18E.

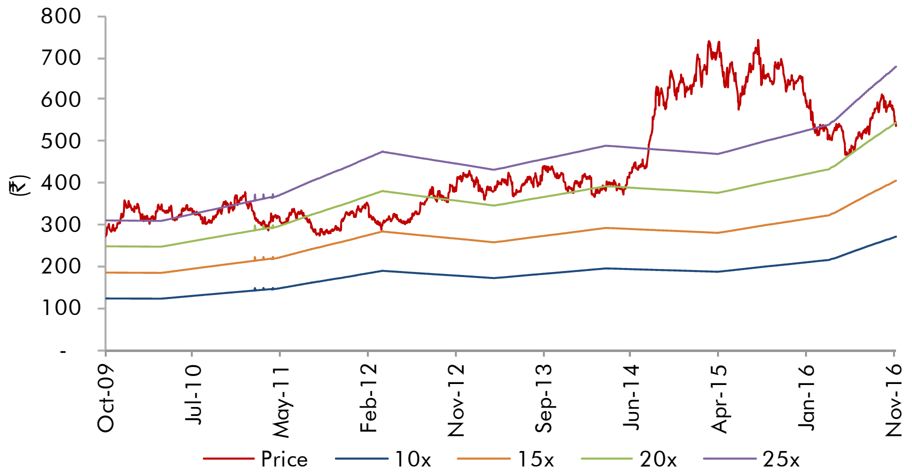
Valuation: We expect the company to post a CAGR of 16.3% in net sales to ₹18,089cr and EPS to record a CAGR of 20.4% to `27.2 over FY2016–18E. The growth in the top-line would be driven by domestic formulation sales and exports. **We maintain our Reduce stance on the stock.**

Exhibit 6: Key assumptions

Key assumptions	FY2017E	FY2018E
Domestic growth (%)	13.0	15.0
Exports growth (%)	19.1	19.2
Growth in employee expenses (%)	15.0	15.0
Operating margins (excl tech. know-how fees) (%)	17.4	18.4

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* %	FY2018E PE (x)	EV/Sales (x)	EV/EBITDA (x)	FY16-18E CAGR in EPS (%)	FY2018E RoCE (%)	RoE (%)
Alembic Pharma	Neutral	655	-	-	21.6	2.9	13.5	(10.8)	27.5	25.3
Aurobindo Pharma	Accumulate	790	877	*10.9*	16.7	2.7	11.6	18.1	22.5	26.1
Cadila Healthcare	Neutral	401	-	-	20.9	3.2	14.7	13.4	22.7	25.7
Cipla	**Neutral**	**564**	**-**	**-**	**20.7**	**2.6**	**14.3**	**20.4**	**13.5**	**15.2**
Dr Reddy's	Neutral	3,274	-	-	22.9	2.9	13.2	1.7	16.2	15.9
Dishman Pharma	Neutral	237	-	-	21.4	2.4	10.5	3.1	10.3	10.9
GSK Pharma*	Neutral	2,616	-	-	43.0	6.5	31.5	17.3	35.3	32.1
Indoco Remedies	Sell	295	240	*(18.5)*	18.4	2.2	11.8	33.2	19.1	20.1
Ipca labs	Neutral	593	-	-	30.1	2.1	13.6	36.5	8.8	9.4
Lupin	Buy	1,493	1,809	*21.1*	21.5	3.5	13.3	17.2	24.4	20.9
Sanofi India*	Neutral	4,265	-	-	24.8	2.7	17.8	22.2	24.9	28.8
Sun Pharma	Buy	667	944	*41.5*	20.3	4.0	12.9	22.0	33.1	18.9

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

Company Background

Cipla is a leading pharmaceutical company in India with a strong presence in both, export and domestic markets. On the exports front, where it follows the partnership model, it has 5,700 product registrations in around 180 countries. Cipla is a market leader in the domestic formulation market with ~5.3% market share. The company is likely to continue on the growth trajectory owing to its entry into the inhalers market in the EU and potential new long-term manufacturing contracts with Global Innovators.

Profit & loss statement (Consolidated)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016	FY2017E	FY2018E
Gross sales	8,196	9,902	11,861	13,587	15,615	18,368
Less: Excise duty	108.7	149.3	179.7	215.0	236.6	278.3
Net sales	8,087	9,753	11,681	13,372	15,378	18,089
Other operating income	193	348	348	306	306	306
Total operating income	**8,279**	**10,100**	**12,029**	**13,678**	**15,684**	**18,395**
% chg	*17.9*	*22.0*	*19.1*	*13.7*	*14.7*	*17.3*
Total expenditure	6,081	7,967	9,612	11,177	12,704	14,760
Net raw materials	2,953	3,875	4,556	5,118	5,736	6,747
Other mfg costs	641	827	993	1,142	1,313	1,510
Personnel	1,036	1,543	2,083	2,447	2,814	3,236
Other	1,451	1,722	1,981	2,470	2,841	3,267
EBITDA	**2,005**	**1,786**	**2,069**	**2,195**	**2,675**	**3,329**
% chg	*35.0*	*(11.0)*	*15.9*	*6.1*	*21.8*	*24.5*
(% of Net Sales)	*24.8*	*18.3*	*17.7*	*16.4*	*17.4*	*18.4*
Depreciation & amort.	330	373	457	542	676	732
EBIT	**1,675**	**1,413**	**1,613**	**1,654**	**1,999**	**2,597**
% chg	*42.7*	*(15.6)*	*14.1*	*2.5*	*20.9*	*30.0*
(% of Net Sales)	*20.7*	*14.5*	*13.8*	*12.4*	*13.0*	*14.4*
Interest & other charges	34	146	85	161	161	161
Other Income	235	266	266	209	209	209
(% of PBT)	*11.4*	*14.1*	*12.4*	*10.4*	*8.9*	*7.1*
Recurring PBT	**2,069**	**1,881**	**2,141**	**2,007**	**2,352**	**2,951**
% chg	*39.3*	*(9.1)*	*13.8*	*(6.3)*	*17.2*	*25.5*
Extraordinary exp./(Inc.)	(26.7)	-	-	-	-	-
PBT (reported)	**2,095**	**1,881**	**2,141**	**2,007**	**2,352**	**2,951**
Tax	544.3	463.4	535.3	439.6	588.0	737.7
(% of PBT)	*26.0*	*24.6*	*25.0*	*21.9*	*25.0*	*25.0*
PAT (reported)	**1,551**	**1,417**	**1,606**	**1,567**	**1,764**	**2,213**
Add: Share of earnings of asso.	(6)	(12)	(12)	(12)	(11)	(10)
Less: Minority interest (MI)	-	16	16	49	17	18
Prior period items	-	-	-	-	-	-
PAT after MI (reported)	**1,545**	**1,388**	**1,578**	**1,506**	**1,736**	**2,185**
ADJ. PAT	**1,524**	**1,388**	**1,578**	**1,506**	**1,736**	**2,185**
% chg	*30.0*	*(8.9)*	*13.6*	*(4.5)*	*15.3*	*25.9*
(% of Net Sales)	*19.1*	*14.2*	*13.5*	*11.3*	*11.3*	*12.1*
Basic EPS (₹)	**19.0**	**17.3**	**19.6**	**18.8**	**21.6**	**27.2**
Fully Diluted EPS (₹)	**19.0**	**17.3**	**19.6**	**18.8**	**21.6**	**27.2**
% chg	*30.0*	*(8.9)*	*13.6*	*(4.5)*	*15.3*	*25.9*

Balance sheet (Consolidated)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016	FY2017E	FY2018E
SOURCES OF FUNDS						
Equity share capital	161	161	161	161	161	161
Preference Capital	-	-	-	-	-	-
Reserves & surplus	8,858	9,890	10,629	11,697	13,245	15,241
Shareholders funds	**9,019**	**10,050**	**10,801**	**11,857**	**13,405**	**15,402**
Minority interest	-	50	180	270	270	270
Total loans	966.9	1,247.9	1,701.8	5,191.4	4,000.0	4,000.0
Other long term liabilities	30.0	32.6	32.6	32.6	32.6	32.6
Long Term Provisions	50.4	77.4	168.4	154.9	154.9	154.9
Deferred tax liability	280.5	309.0	284.6	366.4	366.4	366.4
Total liabilities	**10,347**	**11,767**	**13,169**	**17,872**	**18,229**	**20,226**
APPLICATION OF FUNDS						
Gross block	5,318	6,183	6,868	8,100	8,800	9,500
Less: acc. depreciation	1,708	2,180	2,634	3,176	3,852	4,584
Net block	**3,610**	**4,003**	**4,234**	**4,924**	**4,948**	**4,916**
Capital work-in-progress	378	442	442	442	442	442
Goodwill	-	2,493	2,735	5,713	5,713	5,713
Investments	**2,532**	**709**	**640**	**757**	**757**	**757**
Long Term Loans and Adv.	363	301	419	715	475	559
Current assets	4,775	5,340	7,201	8,262	8,508	10,914
Cash	143	175	564	871	358	1,327
Loans & advances	573	596	701	958	923	1,085
Others	4,058	4,569	5,936	6,432	7,228	8,502
Current liabilities	1,311	1,634	2,501	2,939	2,614	3,075
Net current assets	**3,464**	**3,706**	**4,700**	**5,322**	**5,894**	**7,839**
Mis. Exp. not written off	-	112	-	-	-	-
Total assets	**10,347**	**11,767**	**13,169**	**17,872**	**18,229**	**20,226**

Cash flow statement (Consolidated)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016	FY2017E	FY2018E
Profit before tax	2,095	1,881	2,141	2,007	2,352	2,951
Depreciation	330	373	457	542	676	732
(Inc)/Dec in Working Capital	(667)	(149)	(722)	(611)	(846)	(1,060)
Direct taxes paid	518	431	537	632	-	-
Cash Flow from Operations	**1,241**	**1,673**	**1,339**	**1,306**	**2,182**	**2,623**
(Inc.)/Dec.in Fixed Assets	(698)	(930)	(684)	(1,232)	(700)	(700)
(Inc.)/Dec. in Investments	(1,263)	1,824	69	(117)	-	-
Other income	-	-	-	-	-	-
Cash Flow from Investing	**(1,961)**	**894**	**(616)**	**(1,349)**	**(700)**	**(700)**
Issue of Equity	-	-	-	-	-	-
Inc./(Dec.) in loans	957	311	545	3,476	(1,191)	-
Dividend Paid (Incl. Tax)	(188)	(188)	(188)	(188)	(188)	(188)
Others	4	(2,658)	(692)	(2,938)	410	(766)
Cash Flow from Financing	**773**	**(2,535)**	**(335)**	**350**	**(969)**	**(954)**
Inc./(Dec.) in Cash	53	32	389	307	513	969
Opening Cash balances	**90**	**143**	**175**	**564**	**871**	**358**
Closing Cash balances	**143**	**175**	**564**	**871**	**358**	**1,327**

Key Ratio

Y/E March	FY2013	FY2014	FY2015	FY2016	FY2017E	FY2018E
Valuation Ratio (x)						
P/E (on FDEPS)	29.7	32.6	28.7	30.1	26.1	20.7
P/CEPS	24.1	25.7	22.3	22.1	18.8	15.5
P/BV	5.0	4.5	4.2	3.8	3.4	2.9
Dividend yield (%)	0.4	0.4	0.4	0.4	0.4	0.4
EV/Sales	5.7	4.7	4.0	3.7	3.2	2.6
EV/EBITDA	22.8	25.8	22.3	22.3	18.2	14.3
EV / Total Assets	4.4	3.9	3.5	2.7	2.7	2.4
Per Share Data (₹)						
EPS (Basic)	19.0	17.3	19.6	18.8	21.6	27.2
EPS (fully diluted)	19.0	17.3	19.6	18.8	21.6	27.2
Cash EPS	23.4	21.9	25.3	25.5	30.0	36.3
DPS	2.0	2.0	2.0	2.0	2.0	2.0
Book Value	112.3	125.2	134.5	147.7	166.9	191.8
Dupont Analysis						
EBIT margin	20.7	14.5	13.8	12.4	13.0	14.4
Tax retention ratio	74.0	75.4	75.0	78.1	75.0	75.0
Asset turnover (x)	0.9	0.9	1.0	0.9	0.9	1.0
ROIC (Post-tax)	14.0	10.1	10.3	8.9	8.8	10.8
Cost of Debt (Post Tax)	5.0	9.9	4.3	3.7	2.6	3.0
Leverage (x)	0.0	0.1	0.0	0.0	1.0	2.0
Operating ROE	14.4	10.1	10.3	8.9	14.9	26.3
Returns (%)						
ROCE (Pre-tax)	18.3	12.8	12.9	10.7	11.1	13.5
Angel ROIC (Pre-tax)	19.3	15.3	17.8	16.3	17.7	21.2
ROE	18.3	14.6	15.1	13.3	13.7	15.2
Turnover ratios (x)						
Asset Turnover (Gross Block)	1.7	1.8	1.8	1.8	1.9	2.0
Inventory / Sales (days)	93	95	96	101	87	95
Receivables (days)	71	60	74	58	67	73
Payables (days)	46	41	55	74	43	44
WC cycle (ex-cash) (days)	131	124	116	115	116	120
Solvency ratios (x)						
Net debt to equity	0.1	0.1	0.1	0.4	0.3	0.2
Net debt to EBITDA	0.4	0.6	0.5	2.0	1.4	0.8
Interest Coverage (EBIT/Int.)	-	-	-	-	-	-

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3. Served as an officer, director or employee of the company covered under Research	Yes
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)*