AXIS DIRECT

CADILA HEALTHCARE

PHARMACEUTICALS

18 AUG 2017 Quarterly Update

BUY

Target Price: Rs 540

Q1 miss; outlook strong – upgrade to BUY

Q1FY18 EBITDA margin declined 1,000 bps YoY/ 590 bps QoQ to 12.4% on negative operating leverage, as India sales declined 19% YoY. EBITDA margin adj. for GST stood at ~18%. US sales grew 3% QoQ in USD terms aided by full quarter consolidation of Sentynl. We expect its India business (post GST) growth to rebound to mid-teens and US business (post Moraiya clearance) to post 32% CAGR over FY17-19E, leading to 340 bps/580 bps EBITDA margin expansion to 23.6%/26% in FY18/19.

We largely maintain estimates, but upgrade to **BUY** with a revised TP of Rs 540 (22x FY19 EPS), as we believe it is best positioned (vs. peers) given strong earnings visibility led by monetization of its niche portfolio in India (biosimilar) and US (mesalamine franchise, transdermals).

CMP	: Rs 483
Potential Upside	: 12%

MARKET DATA

No. of Shares	: 1,024 mn
Free Float	: 25%
Market Cap	: Rs 494 bn
52-week High / Low	: Rs 558 / Rs 330
Avg. Daily vol. (6mth)	: 1.4 mn shares
Bloomberg Code	: CDH IB Equity
Promoters Holding	: 75%
FII / DII	: 10% / 7%

- **Q1 miss on weak India sales:** India formulations sales (29% of sales) declined 19% YoY on channel destocking due to GST rollout, while consumer wellness (5% of sales) declined marginally 1% YoY. US sales (45% of sales) grew 18% YoY/ 3% QoQ in USD terms aided by full quarter consolidation of Sentynl as well as launch of gTamiflu in Q4'17. Gross margin declined 347 bps YoY/ 15 bps QoQ to 60.3% (vs. estimate of 61.5%) led by lower India sales and lower margin AG^ (Asacol HD) sales in US. EBITDA margin declined 1,000 bps YoY/ 590 bps QoQ to 12.4% led by negative operating leverage, as lower sales pushed employee and other operating costs as % to sales up. Cadila stated normailized EBITDA margin (adj. for GST) stood at ~18%. Reported EBITDA declined 47% YoY (~40% below estimates), while PAT declined 65% YoY (~55% below our estimate) on higher depreciation and interest cost
- **Monetization of niche pipeline from Moraiya has started** with launch of gLialda – sole generic, gRelpax – 2 generics, and approval for gAsacol HD (currently selling as AG^) which would kick start growth in the US. Additionally, approvals for niche generics gPrevacid Solutab (expected by Dec'17), gTamiflu OS#, gExelon transdermal patch are expected over next 9-12 months. We expect 32% CAGR in US business over FY17-19E

Financial summary (Consolidated)

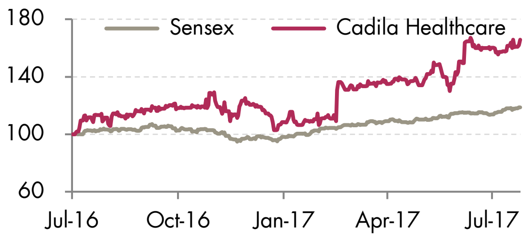
Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs mn)	90,716	92,198	1,15,092	1,33,428
Adj PAT (Rs mn)	19,278	14,879	18,846	25,115
Con. EPS* (Rs)	-	-	19.6	24.3
EPS (Rs)	18.8	14.5	18.4	24.5
Change YOY (%)	66.6	(22.8)	26.7	33.3
P/E (x)	25.6	33.2	26.2	19.7
RoE (%)	38.7	23.5	28.9	35.4
RoCE (%)	28.1	16.3	20.7	26.8
EV/E (x)	21.8	27.8	19.2	14.7
DPS (Rs)	3.2	3.2	3.5	3.9

Source: *Consensus broker estimates, Company, Axis Capita
^AG = Authorized generic #OS- Oral suspension

Key drivers

Growth (%)	FY17	FY18E	FY19E
US	(10)	50	17
India	9	11	13
EBITDA margin (%)	20.3	23.6	26.0
EPS	(23)	27	33

Price performance



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- **Operating leverage, increased capacity utilization to aid margin expansion:** We expect EBITDA margin to expand by ~340 bps to 23.6% in FY18E [vs. normalized EBITDA margin (adj. for GST) of 18% in Q1FY18, 20.2% in FY17] largely led by niche launches (gLialda, gRelpax, etc.) in the US. We expect further margin improvement of 240 bps in FY19E to 26% led by launch of its own generic gAsacol HD – with significantly higher margin vs. ~18-20% margin from AG@ sales in FY18. CDH has already received 24 final approvals FY18 YTD across facilities with ~160 ANDA's still awaiting approval
- **Other concall highlights: (1) US:** Witnessed low to mid double digit YoY price erosion in Q1; **Launch momentum**: CDH launched 3-4 new products in Q1FY18 (received approval for 18 products in Q1FY18) with remaining products to be launched over next 2-3 quarters. **gLialda:** Expects it has 180 day exclusivity (as FDA Formal letter has specified CDH is the first filer); does not expect authorized generic launch; **(3) R&D**: R&D spends increased 25% YoY (-7% QoQ) to Rs 2.04 bn (at 9.4% of Q1FY18 sales vs. 7.2% of Q1FY17 sales). Expects R&D to increase from Q2FY18, towards clinical trials for NCE, ANDA R&D. Filed 2 ANDA's in Q1FY18; **(4) India:** Expects mid teen growth for 9MFY18; expects higher growth in Q2; **(5) Tax rate:** Effective tax <20% for FY18; **(6) Capex:** FY18/19 capex of ~Rs 8-10 bn (excluding M&A) related to automation of facilities

Exhibit 1: Revenue decline led by GST impact on India business

(Rs mn)	% of Q1'18 sales	Q1'17	Q4'17	Q1'18	YoY (%)	QoQ (%)
Domestic	35%	9,023	9,602	7,520	(17)	(22)
Formulations	29%	7,862	8,402	6,374	(19)	(24)
Wellness	5%	1,161	1,200	1,146	(1)	(5)
Exports	63%	13,211	14,526	13,741	4	(5)
Formulations	55%	11,138	12,518	11,995	8	(4)
US (USD mn)		**127**	**146**	**150**	**18**	**3**
US	45%	8,483	9,851	9,650	14	(2)
Europe	3%	792	620	608	(23)	(2)
Latam	2%	527	603	509	(3)	(16)
Other Emerging Markets	6%	1,336	1,444	1,228	(8)	(15)
APIs	3%	976	934	689	(29)	(26)
Animal Health & Others	5%	1,097	1,074	1,057	(4)	(2)
Alliances	2%	390	514	411	5	(20)
Total		22,624	24,642	21,672	(4)	(12)

Source: Axis Capital, Company

Exhibit 2: Other operating income declined YoY

(Rs mn)	Q1'17	Q4'17	Q1'18	YoY	QoQ
Other operating income	707	608	616	(13)	1
- Export Incentive	287	214	272	(5)	27
- Royalty Income	30	2	5	(83)	150
- Net gain on foreign currency transactions	231	(81)	-	(100)	(100)
- Others	159	474	338	113	(29)

Source: Company

Exhibit 3: Lower India sales led to negative operating leverage

(Rs mn)	Q1'17	Q4'17	Q1'18	YoY (%)	QoQ (%)
Revenues	22,624	24,642	21,672	(4)	(12)
Other operating Income	707	607	616	(13)	1
Total revenues	**23,331**	**25,249**	**22,288**	**(4)**	**(12)**
Gross margin (%)	63.8	60.4	60.3	-347 bps	-15 bps
Employees cost	3,572	4,005	4,288	20	7
% to sales	15.8	16.3	19.8	400 bps	353 bps
R&D Expenses	1,626	2,180	2,038	25	(7)
% to sales	7.2	8.8	9.4	222 bps	56 bps
Other Expenditure	4,693	4,677	4,580	(2)	(2)
% of sales	20.7	19.0	21.1	39 bps	215 bps
EBITDA	5,239	4,636	2,773	(47)	(40)
EBITDA margin (%)	22.5	18.4	12.4	-1001 bps	-592 bps
Adjusted EBITDA*	**4,771**	**4,981**	**2,790**	**(42)**	**(44)**
Adjusted EBITDA margins	**20.4**	**19.7**	**12.5**	**-793 bps**	**-721 bps**
Depreciation	843	1,145	1,220	45	7
Other Income	153	731	210	37	(71)
Financial cost	140	99	219	56	121
Profit before tax	4,409	4,123	1,544	(65)	(63)
Effective tax rate	12.3	0.5	19.0	664 bps	1852 bps
Reported PAT	3,984	3,855	1,384	(65)	(64)

Source: Company, as per Ind-AS *margin adjusted for forex

Conference call highlights and our view

Guidance

- **India:** Expect mid-high teen growth in Q2FY18
- **R&D:** 8% of sales in FY18
- **Capex:** FY18/19 capex of ~Rs 8-10 bn (excluding M&A) related to automation of facilities
- **Tax rate:** Current tax of 12-15% in FY18. Effective tax <20% for FY18
- **M&A:** Looking at specialty molecules targeting Pain, Derma, Oncology, GI therapeutic areas in the US, (~USD 100 mn). Also looking at acquiring platforms to expand geographical footprint

US business (USD 150 mn, +18% YoY/ +3% QoQ)

- **Base business** witnessed low to mid double digit YoY price erosion in Q1. US base business (ex Sentynl) was largely flat YoY, as pricing erosion was offset by market share gains
- Received approval for 18 products in Q1FY18. CDH launched 3-4 new products in the quarter, with remaining products to be launched over next 2-3 quarters. It will not be launching ~20% of products due to commercial unviability – development expenses for the same, have been expensed in the P&L
- **gLialda:** Does not expect authorized generic launch. Expects it has 180 day exclusivity (as FDA Formal letter has specified CDH is the First filer). Formal exclusivity not assigned, as no other filer is currently in the final stages of receiving approval
- **Metoprolol XL:** TAD in Mar' 2018
- **Prevacid Solutab:** Expects approval in CY17
- **gTamiflu (oral Suspension):** Expect approval in FY18; only 2 filers
- **gRenvela:** Has an API source problem. Looking for secondary source
- **Transdermal:** Expects approval for couple of products in FY18
  - **gExelon:** Answered all queries, expects approval in FY18

Domestic formulations (Rs 6,374 mn; -19% YoY)

- Impacted by trade channel destocking ahead of GST rollout. Did not offer longer credit terms in Q1FY18
- Expects partial channel restocking in Q2FY18. Witnessed healthy sales in Q2FY18

LatAm (Rs 509 mn; -3% YoY)

- Received approval for 1 product from Anvisa (Brazil), and launched 1 product in Brazil

R&D

- R&D spends increased 25% YoY (-7% QoQ) to Rs 2.04 bn (at 9.4% of Q1FY18 sales vs. 7.2% of Q1FY17 sales). Filed 2 ANDA's in Q1FY18
- Expects R&D to increase from Q2FY18 towards clinical trials for NCE, ANDA R&D

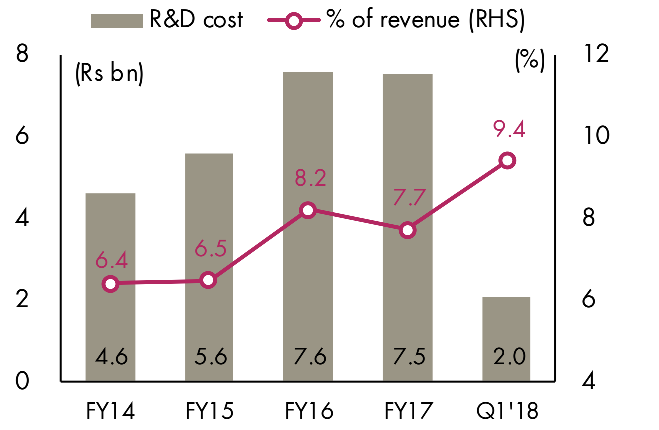
Vaccines

- Received approval to initiate phase 3 trials for 2 vaccines
- Initiated phase 2 trials for 1 vaccine
- To target WHO tenders, Unicef tenders over the next 3 years. All developmental expenses towards vaccines being expensed in P&L

Financials

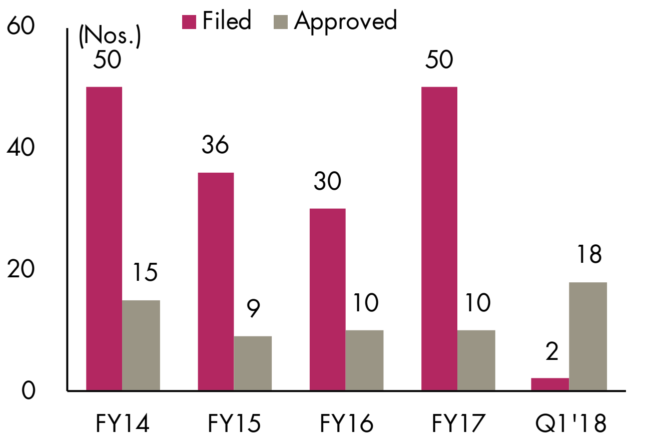
- Normalized EBITDA margin (adjusted for GST) stood at ~18% in Q1FY18 (vs. reported margin of 12.5%)
- Steady gross margin in Q1FY18 due to consolidation of Sentynl Therapeutics despite lower India sales
- No plans to raise funds in the near term

Exhibit 4: Higher R&D expense in Q1'18



Source: Company

Exhibit 5: Significant pickup in approvals in Q1'18



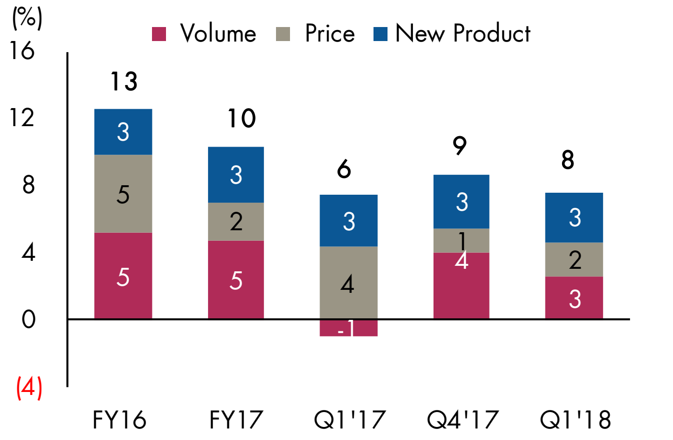
Source: Company

Exhibit 6: Ramp-up in Asacol HD (AG) share continues; HCQS market share steady

Launched	Brand	Brand/Mkt size (USD mn)	No. of generics	Market Share % Jun'16	Sep'16	Dec'16	Mar'17	Apr'17	May'17	Jun'17
2QFY14	Wellbutrin XL	792	5	4	6	<1	<1	<1	<1	<1
2QFY17	Asacol HD (AG)	250	1	-	37	49	58	59	61	62
4QFY14	Tricor (AG)	1,300	7	18	18	18	17	11	7	6
4QFY14	Trilipix (AG)	450	5	23	23	24	23	23	23	23
1QFY15	Zemplar (AG)	109	8	54	64	70	66	65	65	62
2QFY15	Niaspan (AG)	1,000	5	10	8	7	4	3	3	2
Sep '14	Urocit - K	130	2	45	45	46	52	54	55	55
NA	HCQS	100	7	35	30	30	28	30	29	29
3QFY16	Benzonatate	40	9	13	13	14	14	13	14	14

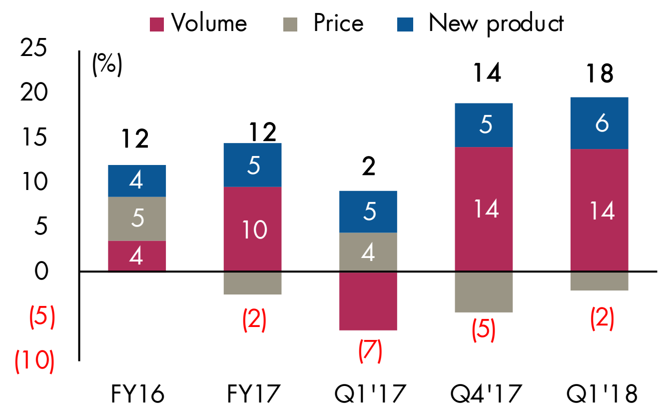
Source: Bloomberg

Exhibit 7: IPM: Lower volume uptake impacted Q1'18 growth



Source: AIOCD, IPM = India Pharma market

Exhibit 8: CDH: Sharp uptick in volumes in recent quarters



Source: AIOCD

Exhibit 9: Sharp uptick in volumes led by improvement in anti-infectives, Pain, anti-Neoplastics segments

YoY growth	% sales	FY16	FY17	Q1'17	Q4'17	Q1'18	Apr'17	May'17	Jun'17
Cardiac	15	12	7	(0)	7	6	7	1	12
Gastro Intestinal	12	10	11	9	12	4	4	2	5
Anti-Infectives	15	19	16	5	6	25	11	35	30
Gynaecological	10	10	(3)	(13)	5	8	6	8	10
Respiratory	10	18	14	3	10	10	13	8	8
Pain / Analgesics	9	13	16	11	14	29	20	31	36
Derma	7	11	13	8	17	(4)	(1)	(7)	(3)
Anti-Neoplastics	6	10	47	5	76	25	(11)	47	39
Vit. / Min / Nut	4	13	23	12	29	22	19	24	23
Anti Malarials	1	14	(26)	(29)	(41)	(5)	(17)	1	(2)
Total (Rs bn)	**47**	**12**	**12**	**2**	**14**	**18**	**8**	**16**	**19**

Source: AIOCD *% of FY17 sales

Financial summary (Consolidated)

Profit & loss (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	90,716	92,198	1,15,092	1,33,428
Other operating income	3,551	2,097	2,250	2,500
Total operating income	**94,267**	**94,295**	**1,17,342**	**1,35,928**
Cost of goods sold	(30,959)	(34,451)	(41,607)	(45,585)
Gross profit	63,308	59,844	75,735	90,342
Gross margin (%)	*69.8*	*64.9*	*65.8*	*67.7*
Total operating expenses	(40,004)	(40,808)	(48,053)	(55,029)
EBITDA	**23,304**	**19,036**	**27,683**	**35,313**
EBITDA margin (%)	*25.7*	*20.6*	*24.1*	*26.5*
Depreciation	(3,001)	(3,750)	(4,779)	(5,191)
EBIT	**20,303**	**15,286**	**22,903**	**30,123**
Net interest	(528)	(450)	(949)	(869)
Other income	1,156	1,286	950	1,250
Profit before tax	**20,926**	**16,121**	**22,904**	**30,504**
Total taxation	(1,774)	(1,289)	(4,008)	(5,338)
Tax rate (%)	*8.5*	*8.0*	*17.5*	*17.5*
Profit after tax	19,152	14,832	18,896	25,165
Minorities	(304)	(291)	(450)	(450)
Profit/ Loss associate co(s)	430	338	400	400
Adjusted net profit	19,278	14,879	18,846	25,115
Adj. PAT margin (%)	*21.3*	*16.1*	*16.4*	*18.8*
Net non-recurring items	(20)	(2)	-	-
Reported net profit	19,258	14,877	18,846	25,115

Balance sheet (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	1,024	1,024	1,024	1,024
Reserves & surplus	55,968	68,576	59,689	80,034
Net worth	56,992	69,600	60,713	81,058
Borrowing	21,073	49,453	45,453	41,453
Other non-current liabilities	2,009	1,164	1,164	1,164
Total liabilities	**81,432**	**1,21,778**	**1,08,891**	**1,25,236**
Gross fixed assets	57,673	81,029	91,029	1,01,029
Less: Depreciation	(20,194)	(23,478)	(28,257)	(33,448)
Net fixed assets	37,479	57,551	62,772	67,581
Add: Capital WIP	9,508	15,433	15,433	15,433
Total fixed assets	46,987	72,984	78,205	83,014
Total Investment	2,487	1,134	1,134	1,134
Inventory	13,371	18,037	19,550	22,664
Debtors	17,466	22,775	20,496	23,761
Cash & bank	6,387	15,435	9,372	17,693
Loans & advances	18,808	21,842	6,306	7,311
Current liabilities	24,074	30,429	26,172	30,341
Net current assets	31,958	47,660	29,553	41,088
Other non-current assets	-	-	-	-
Total assets	**81,432**	**1,21,778**	**1,08,891**	**1,25,236**

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	20,926	16,121	22,904	30,504
Depreciation & Amortisation	3,001	3,750	4,779	5,191
Chg in working capital	*2,717*	*(3,728)*	*12,044*	*(3,215)*
Cash flow from operations	**18,935**	**13,495**	**35,719**	**26,760**
Capital expenditure	*(9,571)*	*(29,734)*	*(10,000)*	*(10,000)*
Cash flow from investing	**(8,635)**	**(29,103)**	**(10,000)**	**(10,000)**
Equity raised/ (repaid)	-	-	-	-
Debt raised/ (repaid)	*(2,367)*	*14,992*	*(4,000)*	*(4,000)*
Dividend paid	*(6,891)*	*(3,938)*	*(4,337)*	*(4,771)*
Cash flow from financing	**(9,700)**	**10,498**	**(9,287)**	**(10,021)**
Net chg in cash	600	(5,110)	16,432	6,739

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
OPERATIONAL				
FDEPS (Rs)	18.8	14.5	18.4	24.5
CEPS (Rs)	21.7	18.2	23.1	29.6
DPS (Rs)	3.2	3.2	3.5	3.9
Dividend payout ratio (%)	17.0	22.0	19.1	15.8
GROWTH				
Net sales (%)	6.8	1.6	24.8	15.9
EBITDA (%)	32.7	(18.3)	45.4	27.6
Adj net profit (%)	66.6	(22.8)	26.7	33.3
FDEPS (%)	66.6	(22.8)	26.7	33.3
PERFORMANCE				
RoE (%)	38.7	23.5	28.9	35.4
RoCE (%)	28.1	16.3	20.7	26.8
EFFICIENCY				
Asset turnover (x)	1.4	1.1	1.1	1.3
Sales/ total assets (x)	0.9	0.7	0.8	0.9
Working capital/ sales (x)	0.3	0.3	0.2	0.2
Receivable days	70.3	90.2	65.0	65.0
Inventory days	68.8	87.5	79.6	82.2
Payable days	67.3	81.2	77.0	79.6
FINANCIAL STABILITY				
Total debt/ equity (x)	0.4	0.8	0.7	0.6
Net debt/ equity (x)	0.2	0.5	0.5	0.3
Current ratio (x)	2.3	2.6	2.1	2.4
Interest cover (x)	38.5	34.0	24.1	34.7
VALUATION				
PE (x)	25.6	33.2	26.2	19.7
EV/ EBITDA (x)	21.8	27.8	19.2	14.7
EV/ Net sales (x)	5.6	5.7	4.6	3.9
PB (x)	8.7	7.1	8.1	6.1
Dividend yield (%)	0.7	0.7	0.7	0.8
Free cash flow yield (%)	-	-	0.1	-

Source: Company, Axis Capital

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Research Team

Sr. No	Name	Designation	E-mail
1	Hiren Trivedi	Research Associate	hiren.trivedi@axissecurities.in
2	Kiran Gawle	Associate	kiran.gawle@axissecurities.in

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HOLD	Between 10% and -10%
SELL	Less than -10%

Axis Securities Limited, Corporate office: Unit No. 2, Phoenix Market City, 15, LBS Road, Near Kamani Junction, Kurla (west), Mumbai-400070, Tel No. – 18002100808/022-61480808, Regd. off.- Axis House, 8th Floor, Wadia International Centre, PandurangBudhkarMarg, Worli, Mumbai – 400 025. Compliance Officer: AnandShaha, Email: compliance.officer@axisdirect.in, Tel No: 022-42671582.