

Sector: Pharmaceuticals  
Result Update

	Change
Reco: Buy	↔
CMP: Rs. 519	
Price Target: Rs. 650	↓
↑ Upgrade   ↔ No change   ↓ Downgrade	

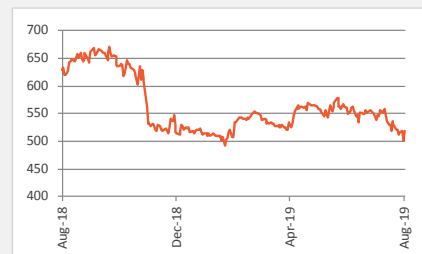
## Company details

Market cap:	Rs. 41,816 cr
52-week high/low:	Rs. 678/484
NSE volume: (No of shares)	21.2 lakh
BSE code:	500087
NSE code:	CIPLA
Sharekhan code:	CIPLA
Free float: (No of shares)	51.0 cr

## Shareholding (%)

Promoters	36.7
FII	26.4
DII	16.2
Others	20.7

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	-8.5	-10.7	-6.0	-20.8
Relative to Sensex	-2.6	-7.5	-6.8	-20.3

Sharekhan Research, Bloomberg

**Q1FY2020** saw Cipla report strong operational numbers. Sales growth remained tepid at 1.3% y-o-y to Rs. 3,989 crore (below our estimates). Operating profit grew by a strong 24.5% y-o-y to Rs. 904.6 crore. OPM improved by 424 bps y-o-y to 22.7% (vs. our expectation of 21.5%). Adjusted profit for the quarter reported a strong growth of 21% y-o-y to Rs 470 .7 crore. During the quarter, US business witnessed a whopping 67% y-o-y jump on account of limited competition product gSensipar (which shall normalise from Q2FY2020 due to increased competition). Domestic business was affected by realignment of distributors in trade generics (as in Q4FY2019) and also ~ deferral of Rs 60-80 crore of sales to Q2FY2020. Gross margin improved significantly by 630 bps to 69.3% due to a limited competition product opportunity. Adjusting for one-offs, the performance was as per expectation.

## Key positives

- Strong gross margin of 69.3% (up 630 bps y-o-y) was reported on the back of better product mix and limited competition launches.
- Operating profit margin (OPM) also improved by 424 bps to 22.7%.
- Company repaid Rs. 187 crore of debt (reducing gross debt to ~Rs. 4,129 crore).
- gAdvair trials are on track and company plans to file the product with USFDA by end of FY2020.
- EIR received for Kurkumbh plant; minimal regulatory woes at key facilities.

## Key negatives

- Domestic business witnessing slowdown, FY2020 growth could be in low single-digits.

## Our Call

**Valuation - Maintain buy with downward revised PT of Rs. 650:** The stock has corrected by ~25% from its high and is currently trading at 14.4x its FY2021E earnings. We feel that the domestic business slowdown and the company's decision to realign distributors (in domestic business) are likely to affect overall growth of the India business in FY2020E. Hence, we have reduced our sales/profit estimates by 10%/8% and 12%/10% for FY2020E and FY2021E, respectively. However, we feel that all these factors are mostly factored in. We expect the company to report sales and profit CAGRs of 14% and 40%, respectively, over FY2019-FY2021E. Also we feel unlike its larger peers, Cipla faces minimal regulatory woes making it a better investment option. Hence, we maintain our Buy recommendation on the stock with downwardly revised price target (PT) of Rs. 650.

## Key Risks

1) Currency fluctuations could hurt as exports form 62% of business, 2) Delay in key product approvals / faster approvals for competitors' products and 3) any regulatory changes in India or South Africa or US could affect business.

## Valuation (Consolidated)

Particulars	FY2018	FY2019	FY2020E	FY2021E
Net sales	15219.3	16362.4	17785.9	21203.6
OPM (%)	18.6	18.9	21.0	23.0
Reported PAT	1416.6	1492.4	2077.1	2905.1
EPS (Rs)	17.6	18.7	25.8	36.1
PER (x)	29.5	27.7	20.1	14.4
EV/Ebitda (x)	16.1	14.9	11.9	8.7
P/BV (x)	2.9	2.8	2.4	2.1
D: E	0.32	0.34	0.25	0.18
ROCE (%)	9.7	11.1	14.4	18.1
RONW (%)	11.2	10.3	12.8	15.4

Source: Company, Sharekhan Estimates

**Domestic business slowdown mostly factored in**

Domestic business (38% of total revenue) was affected by deferral of sales worth Rs. 60-80 crore to Q2FY2020 and also on account of realignment of distributors in the trade generics. The realignment is likely to see a slow turnaround due to movement to new distributors. Management is likely focus on driving growth in the chronic portfolio by launching products in the respiratory segment.

**Other Key Highlights of the quarter**

- ◆ US business grew significantly driven by contribution from products with limited competition. gAdvair trials are on track and filing is expected by end of FY2020. Company plans to file 20 ANDAs in FY2020.
- ◆ South Africa business to grow from Q2FY2020 as private market business picks up.
- ◆ EIR received for Kurkumbh facility; company set to respond to USFDA within the stipulated time for observations at API plant in Virgonagar, Bangalore.

Results	Rs cr				
Particulars	Q1FY2020	Q1FY2019	y-o-y %	Q4FY2019	q-o-q %
Net sales + OOI	3989.0	3939.0	1.3	4404.0	-9.4
Expenditure	3084.4	3212.6	-4.0	3442.9	-10.4
Operating profit	904.6	726.4	24.5	961.0	-5.9
Other income	78.4	90.1	-13.0	95.4	-17.8
EBIDTA	983.0	816.5	20.4	1056.4	-6.9
Interest	52.1	35.1	48.5	44.8	16.4
Depreciation	268.0	241.0	11.2	303.3	-11.6
PBT	662.9	540.4	22.7	708.3	-6.4
Tax	192.2	151.3	27.1	181.7	5.8
Adjusted PAT	470.7	389.1	21.0	526.6	-10.6
Exceptional Item	-23.8	56.5		-169.1	
Reported PAT	446.9	445.6	0.3	357.6	25.0
Adj. EPS (Rs)	5.9	4.8	21.0	6.6	-10.6
			bps		bps
OPM (%)	22.7	18.4	424	21.8	86
EBIDTA margin (%)	24.6	20.7	391	24.0	66
Adj. profit margin (%)	11.8	9.9	192	12.0	-16

Source: Company; Sharekhan Research

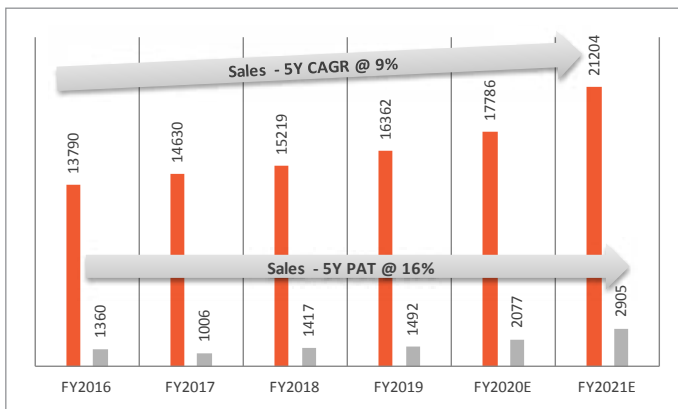
**Geographical Sales Break Up – Quarterly**

Particulars	Q1FY2020	Q1FY2019	y-o-y %	Q4FY2019	QoQ %
India (Rx+Gx)	1355	1544	-12.2	1500	-9.7
North America	1119	670	67.0	1143	-2.1
SAGA	691	831	-16.8	823	-16.0
EM	279	469	-40.5	406	-31.3
Europe	201	134	50.0	236	-14.8
API	182	200	-9.0	174	4.6
Others	160	91	75.8	122	31.1
Total	3987.0	3939.0	1.2	4404.0	-9.5

Source: Company

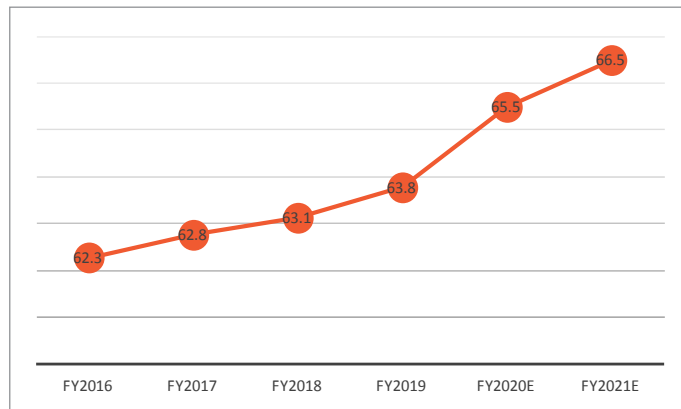
## Financials in charts

### 5Y CAGR – Sales & PAT



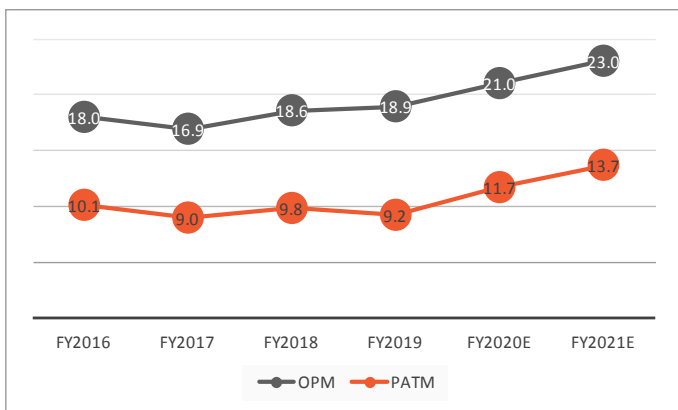
Source: Company, Sharekhan Research

### Improving Gross Margin



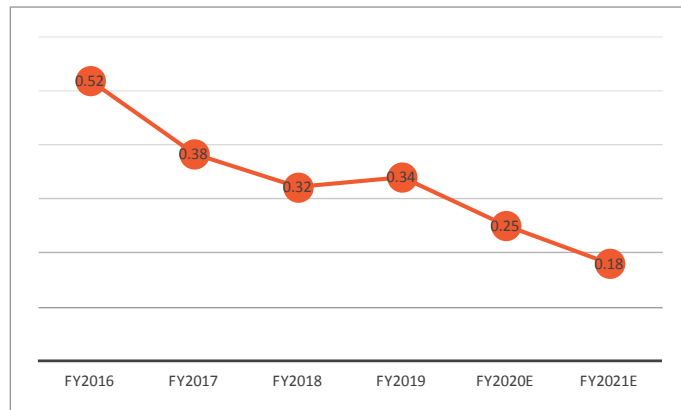
Source: Company, Sharekhan Research

### OPM & PATM



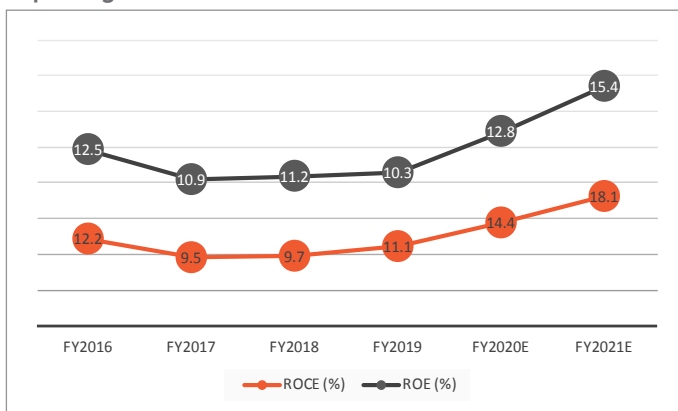
Source: Company, Sharekhan Research

### Improving D: E Ratio



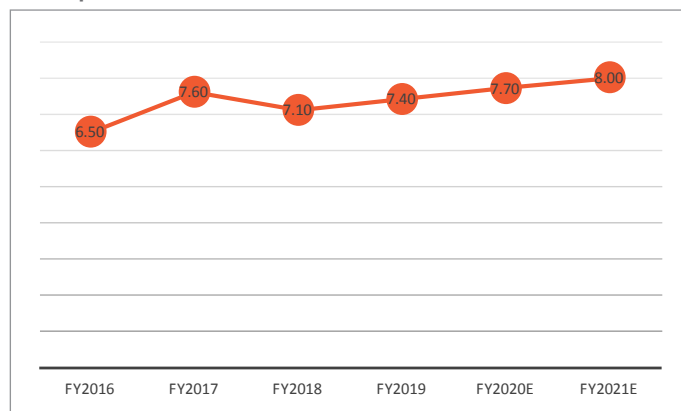
Source: Company, Sharekhan Research

### Improving Return Ratios



Source: Company, Sharekhan Research

### R&D Spend



Source: Company, Sharekhan Research

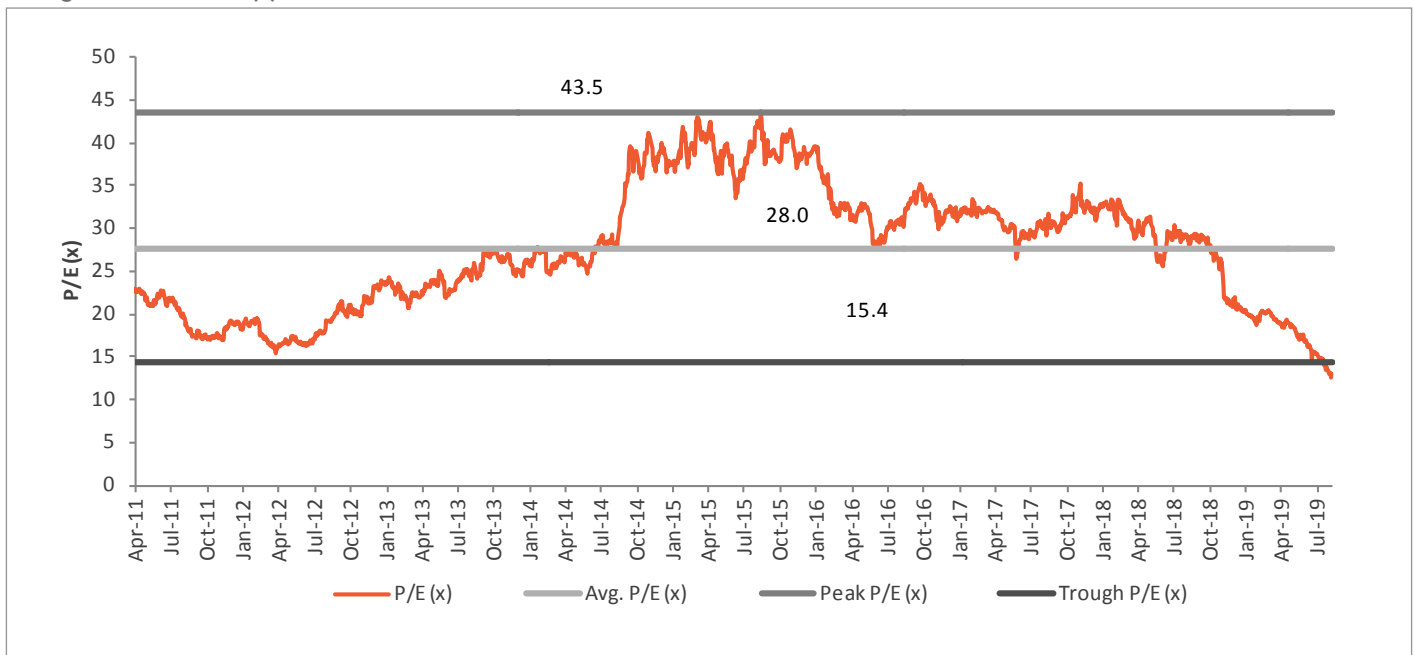
## Outlook

Cipla's current valuations seem to have mostly priced in the slowdown in the India branded products business and increased competition in the US despite limited launches by competitors. Moreover, we feel that unlike its larger peers, Cipla has limited regulatory woes with the USFDA at its key facilities. An improving product mix, increase in capacity utilisation and operational efficiencies will play out well in the next two years, boosting its operating margins and in turn, profitability.

## Valuation - Maintain buy with downward revised TP of Rs 650

Cipla has corrected by ~25% from its high and is currently trading at 14.4x its FY2021E earnings. We feel that the domestic business slowdown and company's decision to realign distributors (in domestic business) is likely affect overall growth of the India business in FY2020E. Hence we have reduced our sales/profit estimates by 10%/8% and 12%/10% for FY2020E and FY2021E, respectively. However, we feel that all these factors are mostly factored in. We expect the company to report sales and profit CAGRs of 14% and 40%, respectively, over FY2019-FY2021E. Also we feel unlike its larger peers, Cipla faces minimal regulatory woes, making it a better investment option. Hence, we maintain our Buy recommendation on the stock with downwardly revised PT of Rs. 650.

One-year forward P/E (x) Band



Source: Sharekhan Research

## Peer Comparison

Particulars	P/E (x)		EV/EBIDTA (x)		RoE (%)		D: E	
	FY20E	FY21E	FY20E	FY2021E	FY20E	FY21E	FY20E	FY21E
Aurobindo	10.1	8.6	6.7	5.8	20.7	19.8	0.50	0.40
Cadila	12.5	11.0	9.4	8.2	15.8	15.8	0.80	0.70
Lupin	27.8	22.3	10.4	8.4	7.2	8.2	0.54	0.48
Sun Pharma	18.7	13.7	11.3	7.9	11.7	13.9	0.21	0.17
Cipla	20.1	14.4	11.9	8.7	12.8	15.4	0.25	0.18

Source: Sharekhan Research

## About company

Cipla is a global pharmaceutical company with a geographically diversified presence and products registered in more than 170 countries. India 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. Cipla is also a well-known global player in inhalers and anti-retrovirals. Going forward, the company is planning launch of 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. Given 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 for the company 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	20.4
2	Commonwealth Bank of Australia	7.7
3	Hamied Mustafa Kamil	4.3
4	ICICI Prudential Asset Management	4.0
5	HDFC Asset Management Co Ltd	2.5
6	Life Insurance Corp of India	2.3
7	Vaziralli Samina	2.2
8	AHMED SOPHIE	1.9
9	Reliance Capital Trustee Co Ltd	1.8
10	BlackRock Inc	1.6

Source: Bloomberg

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