

Sector: Pharmaceuticals  
Result Update

	Change
Reco: <b>Buy</b>	↔
CMP: <b>Rs. 447</b>	
Price Target: <b>Rs. 540</b>	↔

↑ Upgrade ↔ No change ↓ Downgrade

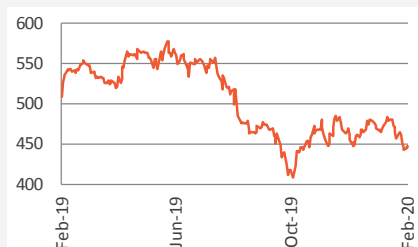
## Company details

Market cap:	Rs. 36,032 cr
52-week high/low:	Rs. 586/390
NSE volume: (No of shares)	28.4 lakh
BSE code:	500087
NSE code:	CIPLA
Sharekhan code:	CIPLA
Free float: (No of shares)	51.1 cr

## Shareholding (%)

Promoters	36.7
FII	21.1
DII	20.9
Others	21.4

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	-5.4	-5.3	-13.9	-14.2
Relative to Sensex	-1.6	-4.6	-20.0	-22.4

Sharekhan Research, Bloomberg

Cipla reported muted results for Q3FY2020. Revenues at Rs. 4,371 crore was up 9% y-o-y led by healthy growth in US and India markets. Operating profits, at Rs 758 crore, grew by 7% y-o-y while OPM contracted by 40 bps y-o-y to 17.3% on the back of a 140 bps y-o-y contraction in gross margins. Adjusted PAT rose by 6% y-o-y to Rs 351 crore and missed estimates. Cipla's domestic business is on a strong footing and is a key growth driver. The management's efforts to merge the three business (prescription, trade generics and consumer health) is expected to yield synergies, which augur well for the company. New launches lined up by the company in the US in the near to medium term would boost revenues. We expect Cipla's topline and PAT to clock a CAGR of 13% and 23%, respectively, over the next two years. Also, the management is working closely with the USFDA to resolve issues at its Goa plant (OAI indicated by the US FDA) and seems confident of a resolution.

## Key positives

- India revenues grow 13% y-o-y as issues relating to distribution highlighted in previous quarter are resolved.
- North America business revenues grew in strong double digit by 11% y-o-y.

## Key negatives

- Gross margins contracted due to a one-off shell stock adjustment and impact of price erosion in Cinacalcet in the US.
- Operating margins contracted by 40 bps.

## Our Call

**Valuation - Maintain Buy with unchanged PT of Rs. 540:** The management's concentrated efforts to structure businesses across geographies for a long-term sustainable growth augurs well. The domestic business, which accounts for a chunk of the revenues is also on a strong footing. With distributor-related issues resolved the business is gaining normalcy. In the US, a strong set of products launches would be key growth drivers. Given the one-time impact of a shell stock adjustment and price erosion in the US business during the quarter, we have tweaked our earnings estimates. We expect Cipla's revenues and PAT to grow by 13% and 23% CAGR over the next two years. Cipla's stock price has corrected by ~20% in the past six months from its highs and is currently trading at an attractive valuation of 13.6x its FY2022E earnings, which is lower than the long-term historical average multiple. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 540.

## Key Risks

1) Currency fluctuations could hurt, as exports form ~60% of business, 2) Delay in key product approvals / faster approvals for competitors' products and 3) any regulatory changes in India, South Africa or the US could affect business.

## Valuation (Consolidated)

	Rs cr				
Particulars	FY2018	FY2019	FY2020E	FY2021E	FY2022E
Net sales	15219.3	16362.4	17732.8	19864.0	22548.1
OPM (%)	18.6	18.9	19.1	19.9	20.6
Reported PAT	1416.6	1492.4	1747.0	2161.5	2643.7
EPS (Rs)	17.6	18.7	21.7	26.8	32.8
PER (x)	25.4	23.9	20.6	16.7	13.6
EV/Ebitda (x)	14.0	13.1	11.7	9.9	8.2
P/BV (x)	2.5	2.4	2.2	1.9	1.7
ROCE (%)	9.7	11.1	12.5	14.5	16.3
RONW (%)	11.2	10.3	11.1	12.3	13.4

Source: Company, Sharekhan Estimates

**Muted earnings:** Cipla reported muted results for Q3FY2020. Lower-than-expected gross margins impacted performance. Revenues, at Rs. 4,371 crore was up 9% y-o-y. Double-digit growth across the Indian and US led to double-digit topline growth. OPMs contracted by 40 bps y-o-y to 17.7% on the back of a 140 bps y-o-y contraction in gross margins, attributable to a one time shell stock adjustment and price erosion impact of Cinacalcet. Operating profits at Rs. 758 crore grew 7% y-o-y and was lower than estimates. Reflecting the operating performance, PAT stood at Rs 351 crore, up by 6% y-o-y and is below estimates.

**Domestic business on a strong footing; to be key growth driver:** Cipla's domestic business accounts for 40% of revenue, is on a strong footing. Revenues from the domestic business have grown by 13% y-o-y. The issues in the recent past relating to realignment of distributors have been fully resolved and the business is gaining normalcy. The India business primarily comprises of prescription, trade generics and consumer health. Considering the shift in demand patterns and to harness synergies, the management plans to merge all the three business under one head. The synergies would encompass areas including product portfolio, distribution and consumer focused initiatives, which in turn would enhance the operating efficiencies for the company. The management is looking to sustain the strong growth momentum in the India business, leveraging the healthy growth in the prescription and generics space.

### Key Conference call highlights

- ♦ **Regulatory updates:** Cipla's Goa plant was inspected between September 16 and 27, 2019. The inspection resulted in Form-483 issued to Cipla with 12 observations, with none of them relating to data integrity issues. However, in the recent past, the US FDA has indicated of an OAI status for the Goa plant. Further the US FDA also inspected the companies Patalganga facility (both formulations and APIs). The inspection ended with 4 observations. The management is working closely with the regulatory to resolve the issues.
- ♦ **India business:** The trade generics and prescription businesses grew by a healthy pace in Q3FY20. The prescription business grew by 14% y-o-y, while the trade generics business grew 7% y-o-y. The company has acquired the trademarks rights for Vysov and Vysov M, in the diabetics space. it would be co-marketing the product in India.
- ♦ **South African business:** The South African business which includes South Africa, Sub-Saharan and global access grew by a sturdy 20% y-o-y in local currency terms, and outpaced market growth. Cipla's Mirren portfolio is growing strongly and is now the third- largest player in the over-the-counter (OTC) segment.
- ♦ **North America:** The North American market grew strongly by 11%. Cipla plans to focus on maximizing value opportunity in key commercial assets in the US and finalise out-licensing for CNS Specialty assets.
- ♦ **Coronavirus:** The Management has stated that if the coronavirus issue gets extended by 30-45 days more, then it could have an adverse effect on the pharma industry as a substantial share of value chain is dependent on China sourcing.
- ♦ **New launches & fillings:** The company aims to submit the Tramadol NDA later in the year. The company is expecting to file gProventil in H1FY21. Also it is aiming to file gAdvair in FY21 in the low completion space) and is looking for another filing in the respiratory space in the near term.
- ♦ **Gross Margins Guidance:** Cipla has guided for gross margins of 63-64% for FY2020/FY2021.
- ♦ **R&D:** R&D spends stood at Rs. 308 crore, at 7% of sales. The management expects the R&D spends to peak off from here on.

## Results

Particulars	Q3FY2020	Q3FY2019	y-o-y %	Q2FY2020	q-o-q %
Net sales	4371.0	4007.5	9.1	4395.8	-0.6
Operating profit	758.3	707.7	7.2	909.5	-16.6
EBIDTA	830.5	786.2	5.6	1010.0	-17.8
Interest	46.2	44.2	4.5	46.1	0.3
Depreciation	277.9	293.1	-5.2	283.0	-1.8
PBT	506.4	448.9	12.8	681.0	-25.6
Tax	152.8	125.7	21.6	200.6	-23.8
Adjusted PAT	351.0	332.2	5.7	471.4	-25.5
Reported PAT	351.0	332.2	5.7	471.4	-25.5
Adj. EPS (Rs)	4.4	4.1	5.7	5.9	-25.5
			<b>bps</b>		<b>bps</b>
OPM (%)	17.3	17.7	-40	20.7	-334

Source: Company; Sharekhan Research

## Geographical Sales Break Up – Quarterly

Geography mix	Q3FY2020	Q3FY2019	y-o-y %	Q2FY2020	q-o-q %
India (Rx+Gx)	1777	1577	12.7	1730	2.7
North America	946	849	11.4	953	-0.7
SAGA	831	782	6.3	740	12.3
EM	323	393	-17.8	451	-28.4
Europe	190	191	-0.5	190	0.0
API	165	155	6.5	157	5.1
Others	140	60	133.3	174	-19.5
<b>Total</b>	<b>4372.0</b>	<b>4007.0</b>	<b>9.1</b>	<b>4395.0</b>	<b>-0.5</b>

Source: Company

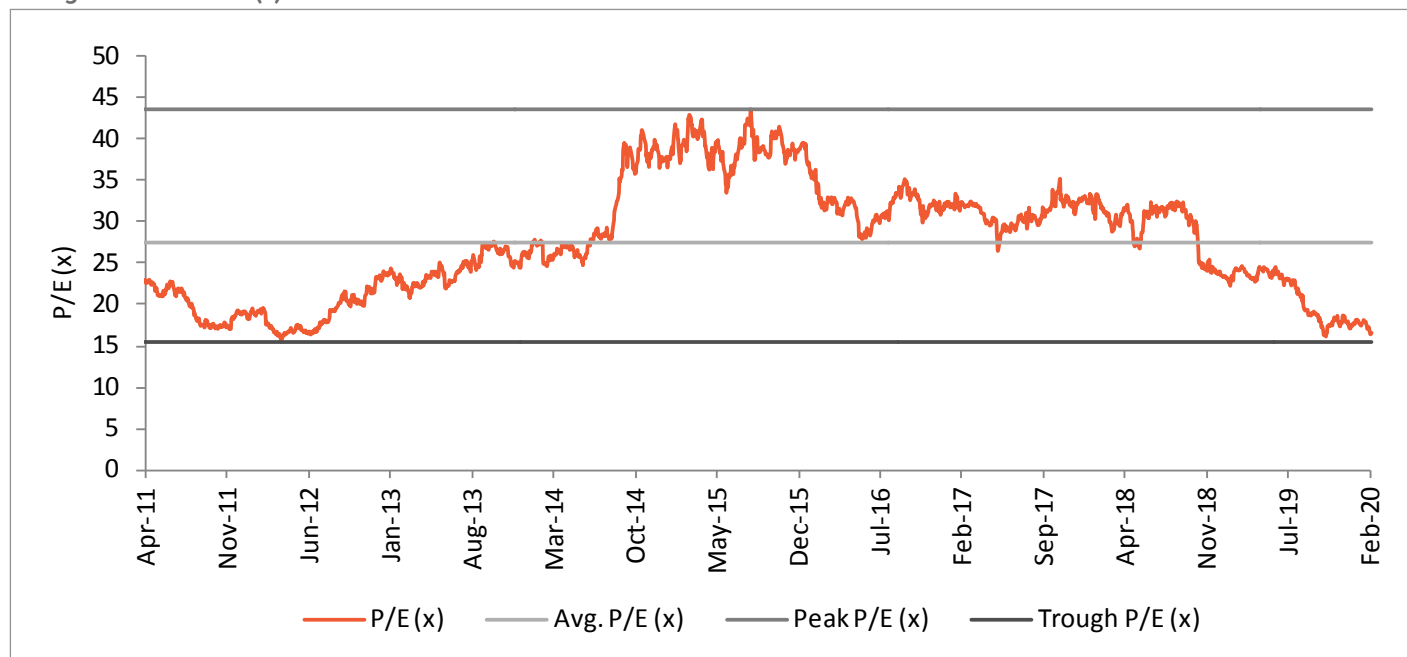
## Outlook

Cipla's domestic business would be a key growth driver. The management's concentrated efforts to generate synergies by merging all the three business in India under one umbrella is expected to yield significant benefits. Issues around the re-alignment of distributors have been resolved, which augurs well for the company. Backed by a strong product launch pipeline, the US business is expected to report a healthy growth. Also business across other geographies too are well set to capitalize on the upcoming opportunities and are likely to gain traction.

## Valuation

**Valuation - Maintain Buy with unchanged PT of Rs. 540:** The management's concentrated efforts to structure businesses across geographies for a long-term sustainable growth augurs well. The domestic business, which accounts for a chunk of the revenues is also on a strong footing. With distributor-related issues resolved the business is gaining normalcy. In the US, a strong set of products launches would be key growth drivers. Given the one-time impact of a shell stock adjustment and price erosion in the US business during the quarter, we have tweaked our earnings estimates. We expect Cipla's revenues and PAT to grow by 13% and 23% CAGR over the next two years. Cipla's stock price has corrected by ~20% in the past six months from its highs and is currently trading at an attractive valuation of 13.6x its FY2022E earnings, which is lower than the long-term historical average multiple. We maintain our Buy recommendation on the stock with an unchanged 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	ICICI Prudential Asset Management	6.03
2	Life Insurance Corp of India	3.48
3	First State Investments ICVC	3.12
4	HDFC Asset Management Co Ltd	3.08
5	Aditya Birla Sun Life Asset Manage	1.84
6	Reliance Capital Trustee Co Ltd	1.73
7	BlackRock Inc	1.52
8	Vanguard Group Inc/The	1.45
9	Norges Bank	1.35
10	GOVERNMENT PENSION FUND - GLOBAL	1.22

Source: Bloomberg

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by BNP PARIBAS

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