

Sector: Pharmaceuticals
Result Update

	Change
Reco: Buy	↔
CMP: Rs. 570	
Price Target: Rs. 650	↔
↑ Upgrade ↔ No change ↓ Downgrade	

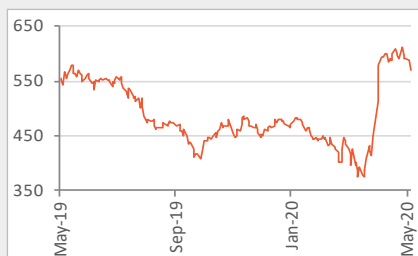
Company details

Market cap:	Rs. 45,972 cr
52-week high/low:	Rs. 632/357
NSE volume: (No of shares)	33.1 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	-3.8	27.5	23.1	2.6
Relative to Sensex	-6.1	52.1	45.9	18.8

Sharekhan Research, Bloomberg

Cipla reported weak numbers for Q4FY2020 impacted by the ongoing COVID-19 pandemic, which led to operational disruptions. Revenues were flat at Rs. 4,376 crore. The India and the API business grew in double digits while the North America business reported a decline in revenue. Operating profits, at Rs 633 crore, dropped by 34% y-o-y while OPM contracted by 730 bps y-o-y to 14.5%. OPM reflected an impact of 200 bps on account of the COVID-19 related issues. Adjusted PAT at Rs. 246 crore dropped by 53% y-o-y. The management expects the impact of COVID-19 to be short-lived and has guided for a recovery in the near term. Cipla's domestic business is on a strong footing and is a key growth driver. The management's efforts to merge three businesses (prescription, trade generics and consumer health) are expected to yield synergies, which augur well for the company. New launches lined up in the US in the near to medium term would boost revenues. Cipla has recently partnered with a US based pharma company to manufacture and supply Remdesivir, an investigational drug to treat Covid-19. The USFDA approval for generic Albuterol and the successful completion of Phase-III clinical study of generic Advair Duskus would strengthened Cipla's respiratory franchise in the US market, which provides ample growth visibility. We expect Cipla's topline and PAT to clock a CAGR of 10% and 30%, respectively, over FY2020-FY2022E. Also, the management is working closely with the USFDA to resolve issues around its Goa plant (OAI indicated by the US FDA) and has submitted its reply to the regulator.

Key positives

- India revenues grew by 12.2% y-o-y with both prescription and generic businesses reporting healthy growth.
- South African business recorded a strong 10% growth in the local currency terms.

Key negatives

- COVID-19 pandemic impacted overall performance.
- Operating margins contracted by 730 bps.

Our Call

Valuation - Maintain Buy with unchanged PT of Rs. 650: The management's concentrated efforts to structure businesses across geographies for a long-term sustainable growth augurs well. The domestic business, which accounts for 40% of sales is set to be the key growth driver. In the US, a strong set of product launches would fuel the growth. Overall the management sees the India business to lead the growth, while the South African business is expected to clock a healthy growth. On account of a disruption due to the COVID-19 pandemic, Cipla reported weak results for Q4FY2020 with the PAT missing estimates. The management sees this as a short-term phenomenon and expects a recovery soon. We have fine-tuned our earnings estimates for FY2020/FY2021E. We expect Cipla's revenues and PAT to grow at a 10% and 30% CAGR over FY2020-FY2022. Currently the stock is trading at valuation of 23.7x / 18.1x its FY2021 / FY2022E earnings, which is lower than the long-term historical average multiple. Healthy topline growth, strong earnings visibility and a healthy balance sheet augur well and would support multiple expansion. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 650.

Key Risks

- 1) Currency fluctuations, 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)

Particulars	FY2018	FY2019	FY2020	FY2021E	FY2022E
Net sales	15219.3	16362.4	17132.0	18698.9	20653.4
OPM (%)	18.6	18.9	18.7	19.2	20.8
Reported PAT	1416.6	1492.4	1499.5	1935.2	2533.6
EPS (Rs)	17.6	18.7	19.2	24.0	31.4
PER (x)	32.4	30.4	29.7	23.7	18.1
EV/Ebitda (x)	17.5	16.3	15.2	13.4	10.9
P/BV (x)	3.2	3.1	2.9	2.6	2.3
ROCE (%)	9.7	11.1	11.6	13.6	16.0
RONW (%)	11.2	10.3	10.1	11.6	13.6

Source: Company; Sharekhan estimates

Weak operating performance; PAT missed estimates: Cipla reported weak results for Q4FY2020. Revenues at Rs. 4,376 crore were almost flat y-o-y. Adjusting for Cinacalcet in corresponding quarter, the revenues were up 7% y-o-y. The ongoing COVID-19 pandemic impacted deliveries of up to Rs 200 crore for the quarter and consequently OPM was also impacted to the extent of 200 bps. The Indian operations and the API business clocked a 12% and 42% y-o-y growth. North American operations declined by 25% y-o-y. OPM contracted steeply by 730 bps y-o-y to 14.5% on the back of 450 bps drop in gross margins and increasing cost pressures. Consequently, the EBITDA stood at Rs 633 crore, declining by 34% y-o-y. Tracking the weak operating performance, the adjusted PAT for the quarter declined 53% y-o-y to Rs 246 crore and missed our estimates of Rs 360 crore.

Domestic business restructured; to be key revenue driver: Cipla's domestic business accounts for around 40% of revenue. The business witnessed disruptions on account of COVID-19, which impacted the sales for the quarter. The management seems confident of a revival in the near term and expects the India business to gain traction. This business primarily comprises prescription, trade generics and consumer health. Over the recent past the management has successfully merged three segments (Trade + prescription+ OTC) in the domestic business, to leverage the existing product portfolio and distribution reach. Moreover, issues relating to realignment of distributors have been fully resolved. With the restructuring of the domestic business largely done, the management is looking at a strong growth momentum from the India business, leveraging the healthy growth in the prescription and generics space. The trade generics business recorded a growth of 15%. Cipla acquired four umbrella brands in the nutraceutical segment, which would further strengthen presence in the women's health category. Cumulatively, the India business is expected to grow in healthy double digits.

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. However, in the recent past, the US FDA has indicated of an OAI status for the Goa plant. The company has submitted its responses to the USFDA and is awaiting a reply from the regulator.
- ◆ **South African business:** The South African business, which includes South Africa, Sub-Saharan and global access grew by 10% y-o-y in local currency terms. The company is the third-largest pharma player in the South African private market with a share of 6.9%. The Sub-Saharan Africa business was impacted by receivables related challenges.
- ◆ **North America:** Revenues declined by 25% y-o-y for the quarter. The pipeline for the US business is strong with unlocking of respiratory franchise in the US with the launch of the generic Albuterol. Cipla recently launched Esomeprazole for oral suspension being the first to file on the 10 mg strength.
- ◆ **New launches & fillings:** Cipla is working with USFDA on IV Tramadol NDA submitted in December via Avenue Therapeutics. Also, the management expects to file another complex inhaler in the limited competition space. Also the company is expected to file Advair immediately over the next few days and expects the approval to be coming on over 18-24 months.
- ◆ **Emerging markets:** The emerging market business was flat owing to COVID-19 related logistical challenges with a recovery likely in Q1FY21. The API business grew by 42% for the quarter driven by continued momentum in global seedings & lock-ins.
- ◆ **R&D:** R&D spends stood at Rs. 311 crore, at 7% of sales. The management expects R&D spends to peak off from hereon.

Results

Particulars (Rs Cr)	Rs cr				
	Q4FY2020	Q4FY2019	y-o-y %	Q3FY2020	q-o-q %
Net sales	4376.2	4404.0	-0.6	4371.0	0.1
Operating profit	633.5	961.0	-34.1	758.3	-16.5
Other income	93.2	95.4	-2.3	72.1	29.2
EBIDTA	726.7	1056.4	-31.2	830.5	-12.5
Interest	53.0	44.8	18.4	46.2	14.7
Depreciation	345.8	303.3	14.0	277.9	24.4
PBT	327.9	708.3	-53.7	506.4	-35.2
Adjusted PAT	246.0	520.2	-52.7	351.0	-29.9
			bps		bps
OPM (%)	14.5	21.8	-735	17.3	-287

Source: Company; Sharekhan Research

Geographical Sales Break Up – Quarterly

Geography Mix	Rs cr				
	Q4FY2020	Q4FY2019	y-o-y %	Q3FY2020	q-o-q %
India (Rx+Gx)	1730	1542	12.2	1777	-2.6
North America	856	1143	-25.1	946	-9.5
SAGA	825	822	0.4	831	-0.7
EM	415	406	2.2	323	28.5
Europe	232	236	-1.7	190	22.1
API	247	174	42.0	165	49.7
Others	71	81	-12.3	140	-49.3
Total	4376.0	4404.0	-0.6	4372.0	0.1

Source: Company; Sharekhan Research

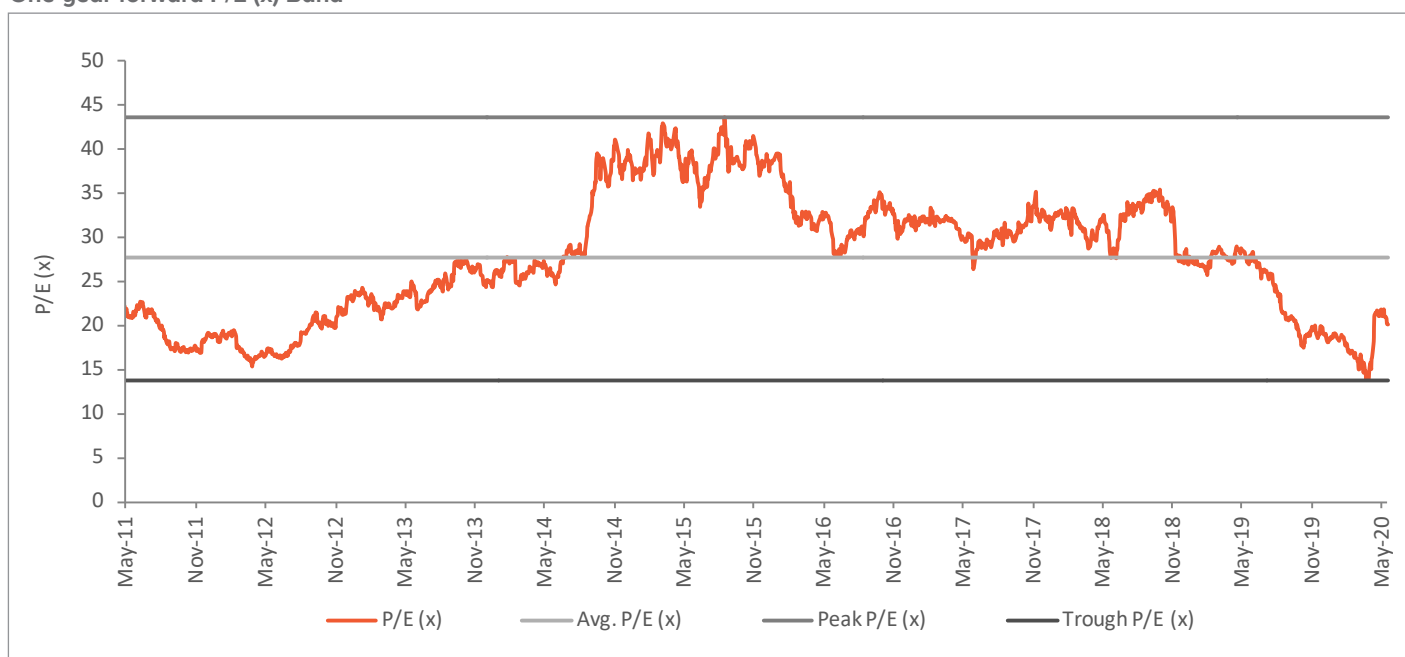
Outlook

Cipla’s domestic business would be a key growth driver. The management’s concentrated efforts to generate synergies by merging all the three businesses in India under one umbrella is expected to yield significant benefits. Issues around re-alignment of distributors have been resolved, which augurs well. Backed by a strong product launch pipeline, the US business is expected to report a healthy growth. Also, businesses across other geographies are well set to capitalise on the upcoming opportunities and are likely to gain traction. The ongoing Covid-19 Pandemic has impacted the company’s performance in terms of supply disruptions. However the management is confident of a recovery in the near term.

Valuation

Maintain Buy with unchanged PT of Rs. 650: The management’s concentrated efforts to structure businesses across geographies for a long-term sustainable growth augurs well. The domestic business, which accounts for 40% of sales is set to be the key growth driver. With most distributor-related issues resolved the business is gaining normalcy. In the US, a strong set of product launches would fuel the growth. Overall the management sees the India business to lead the growth, while the South African business is expected to clock a healthy growth. On account of a disruption due to the COVID-19 pandemic, Cipla reported weak results for Q4FY2020 with the PAT missing estimates. The management sees this as a short-term phenomenon and expects a recovery soon. We have fine-tuned our earnings estimates for FY2020/FY2021E. We expect Cipla’s revenues and PAT to grow at a 10% and 30% CAGR over FY2020-FY2022. Currently the stock is trading at valuation of 23.7x / 18.1x its FY2021 / FY2022E earnings, which is lower than the long-term historical average multiple. Healthy topline growth, strong earnings visibility and a healthy balance sheet augur well and would support multiple expansion. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 650.

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 have an adverse impact.
- ◆ 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	6.32
2	Life Insurance Corp of India	3.74
3	First State Investments ICVC	3.12
4	HDFC Asset Management Co Ltd	2.77
5	Aditya Birla Sun Life Asset Manage	2.33
6	SBI Fund Management	1.65
7	Vanguard Group Inc/The	1.51
8	BlackRock Inc	1.26
9	GOVERNMENT PENSION FUND - GLOBAL	1.16
10	Norges Bank	1.16

Source: Bloomberg

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