

Stellar Q1, balancing growth with cost leadership-new mantra

Cipla's mantra of 'Balancing growth with cost leadership' reflects in its guidance of cost savings of ~Rs5bn in FY21 led by (1) leveraging digital technology in India branded formulations – marketing, promotions, conferences, product launches, (2) calibration of R&D – focussed products in inhalation. Cipla is hopeful of leveraging the digitization practice beyond FY21 and guided for healthy operating performance. Besides attaining cost efficiencies, it is working towards becoming the global leader in inhalation (Cipla is 2nd led by GSK). Cipla has been working on six inhalation products, with launches planned between FY21-25. Of the six, Albuterol (launched, MS-65%), ProAir (approved in 4Q, working on queries), Advair and Spiriva (filed), Symbicort (in clinics). It has also launched DHE nasal spray with 180-days exclusivity. We see increasing visibility over the medium-term earnings, given signs of improving execution in India and strong US build-out.

Change in capital allocation (focus on India business -Rx, Tx & OTC convergence), phasing out of R&D investments (calibration in US investments) and focus on deepening penetration in South Africa, Australia and China form core strategy of Cipla. Approval for gProAir (queries should be responded by partner towards end of this year) and a launch of gAdvair are expected to be the key catalysts in near term. While Q2 may be a little soft for the US (Albuterol channel filing), key transient issues, particularly for the domestic business, are now in the base. Factoring in the improved operating performance and guidance of 20%+ EBITDA margins in FY21, we have upgraded our earnings by 2%/13% for FY21/22 respectively. We pencil in 300 bps margin improvement over FY20-22E. At CMP, the stock trades at 27x/22.7x our FY21/22 EPS of Rs26.6 and Rs32.2 respectively. Accumulate.

Leveraging digital technology: Cipla guided for ~Rs5bn cost savings in FY21 and sustain beyond. This is largely expected from changing the business platform to digital. As on date, branded business in India was led by promotions and marketing through a large sales force. With the pandemic, company has decided to opt for digitization and organize conferences, product launches through an online platform. This could lead to huge savings if successful.

Q1FY21 Result (Rs Mn)

Particulars	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Revenue	43,462	39,890	9.0	43,762	(0.7)
Total Expense	32,974	30,844	6.9	37,427	(11.9)
EBITDA	10,487	9,046	15.9	6,335	65.5
Depreciation	2,690	2,680	0.4	3,458	(22.2)
EBIT	7,798	6,366	22.5	2,877	171.0
Other Income	655	784	(16.5)	932	(29.8)
Interest	460	521	(11.7)	530	(13.2)
EBT	7,992	6,629	20.6	3,279	143.7
Tax	2,278	1,922	18.5	936	143.5
RPAT	5,779	4,472	29.2	2,380	142.8
APAT	5,779	4,472	29.2	2,380	142.8
			(bps)		(bps)
Gross Margin (%)	63.4	70.0	(658)	61.4	202
EBITDA Margin (%)	24.1	22.7	145	14.5	965
NPM (%)	13.3	11.2	209	5.4	786
Tax Rate (%)	28.5	29.0	(50)	28.5	(3)
EBIT Margin (%)	17.9	16.0	198	6.6	1137

CMP	Rs 729
Target / Upside	Rs 804 / 10%
BSE Sensex	38,047
NSE Nifty	11,214

Scrip Details

Equity / FV	Rs 1,613mn / Rs 2
Market Cap	Rs 587bn
	US\$ 8bn
52-week High/Low	Rs 740/Rs 355
Avg. Volume (no)	7,592,800
NSE Symbol	CIPLA
Bloomberg Code	CIPLA IN

Shareholding Pattern Jun'20(%)

Promoters	36.7
MF/Banks/FIs	22.6
FIIIs	18.0
Public / Others	22.7

Valuation (x)

	FY20A	FY21E	FY22E
P/E	38.0	27.4	22.7
EV/EBITDA	18.6	14.8	12.5
ROE (%)	10.1	12.9	13.8
RoACE (%)	8.3	10.6	11.5

Estimates (Rs mn)

	FY20A	FY21E	FY22E
Revenue	171,320	191,013	207,837
EBITDA	32,060	39,518	45,020
PAT	15,465	21,452	25,927
EPS (Rs.)	19.2	26.6	32.2

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Company indicated that there could be some hiccups in transition and some costs could bounce back. But it remains confident of this adapting to change. Cipla has a sales force of ~9000 MRs. We build in strong operating leverage from this exercise and believe this could lead to some structural changes in way of doing business in India.

Q1FY21 Result Snapshot: Cipla reported a superlative performance across all fronts led by strong performance in domestic formulations ably supported by favourable currency and improved formulations ex-US. US reported \$135mn sales (up 14% QoQ, down 16% YoY on a higher base of gSensipar) led by swift ramp up in Albuterol. Sales grew 10% YoY, EBITDA margin at 24% and PAT at Rs5.8bn, way higher than our estimates. Strong traction in India business (up 16% YoY) was led by branded formulations (9% YoY), trade generics (46% YoY) and consumer business. Other geographies were in line aided by currency.

Other highlights:

- 1) On the balance sheet front, Cipla is now a net cash company. Long term debt stands at \$317mn.
- 2) Tax rate guided at 28% for FY21E.
- 3) Gross margins guided at 63-64% and EBITDA margins at 20%+ for FY21E

Exhibit 1: Revenue Mix

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)	FY20	FY19	YoY (%)
Domestic Formulations	16,080	13,880	15.9	17,390	(7.5)	65,111	62,720	3.8
Export Formulations	25,661	24,500	4.7	23,659	8.5	96,812	93,934	3.1
North America	9,837	11,190	(12.1)	8,603	14.3	38,378	34,210	12.2
South Africa	7,698	6,910	11.4	8,173	(5.8)	30,051	31,830	(5.6)
ROW	4,705	2,790	68.6	3,871	21.5	15,026	17,400	(13.6)
Europe	2,566	2,010	27.7	2,151	19.3	8,348	7,020	18.9
Others	855	1,600	(46.5)	860	(0.6)	5,009	3,474	44.2
APIs	1,711	1,820	(6.0)	2,581	(33.7)	6,678	7,010	(4.7)
Total	43,452	40,200	8.1	43,630	(0.4)	168,601	163,664	3.0

Source: Company, DART

Concall Takeaways:

- **Strategy:** Cipla guided for a change in its strategy highlighting channeling **capital allocation and resources towards becoming a global leader in inhalation**. It has guided for steady state R&D (5-6% of sales) as trials for Advair are complete. Besides, it is re-prioritizing its specialty assets which should keep R&D spend in check.
- **Cipla's US specialty strategy:** Cipla guided ~18-20 months in gAdvair launch. Focus will be more institutional based products in the US specialty. It is also exploring out-licensing opportunities for CNS assets. Cipla has been working on six inhalation products, with launches planned between FY21-25. Of the six, Albuterol (launched, MS-65%), ProAir (approved in 4Q, working on queries), Advair and Spiriva (filed), Symbicort (in clinics). It has also launched DHE nasal spray with 180-days exclusivity.
- **US:** US reported sales of US\$135mn (vs our expectation of \$150mn) led by ramp up in Albuterol. Management indicated that pricing of Albuterol is largely stable (prices are lower by 25-30% since Jan). It does now see more competition except Lupin in the near term and expects prices to remain respectable. Being a large market with high volumes, management remains confident of doing well despite 6-7 players. Cipla continues to focus on one specialty launch every quarter and subsequent quarters shall see some interesting launches.
- **India business:** India formulations reported 16% growth YoY led by 46% YoY growth in trade generics post restructuring and 9% YoY growth in branded generics. Strong traction in Chronic therapies with helped offset subdued acute demand and slowdown in hospital portfolio. As per IQVIA, Cipla recording strong growth in respiratory, neuro and inhalation therapies outperforming the IPM. Besides, Cipla has entered into a partnership with Boehringer Ingelheim for 3 anti-diabetic products which are SGLT2 DDp2 inhibitors. Also, extended partnership with Roche for 3 oncology products (trastuzumab, rituximab and 1 more). This in line with management's guidance of driving growth through in-licensing products. Further, its consumer business is gaining traction.
- **COVID:** Cipla has launched Remdesivir and Favipiravir in India. Contribution of these drugs were miniscule in Q1. With supply side back log clear for Remdesivir, Cipla now manufactures the drug only on demand.
- **South Africa & Global Access (SAGA)** revenue grew 11% aided by currency and traction in the private market channel in South Africa led by new launches. TLD monetization has already started in SA. Cipla guided for a double digit growth in FY21 for the private market as the regulatory agencies are expediting approvals and clearing backlogs.
- **Emerging markets** grew 69% YoY (50% CC growth). Focus on leveraging its respiratory and oncology portfolio in Brazil and China shall aid growth in EM. Launch of biosimilars in the next 2 years shall aid growth.

Profit and Loss Account

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Revenue	163,624	171,320	191,013	207,837
Total Expense	132,651	139,260	151,495	162,817
COGS	57,845	59,914	66,682	71,473
Employees Cost	28,565	30,270	32,839	36,578
Other expenses	46,241	49,076	51,974	54,766
EBIDTA	30,973	32,060	39,518	45,020
Depreciation	13,263	11,747	11,982	12,727
EBIT	17,710	20,313	27,536	32,293
Interest	1,684	1,974	1,308	927
Other Income	4,766	3,442	3,508	3,542
Exc. / E.O. items	0	0	0	0
EBT	20,791	21,782	29,736	34,909
Tax	5,695	6,312	8,326	9,076
RPAT	15,277	15,465	21,452	25,927
Minority Interest	(353)	(470)	(517)	(569)
Profit/Loss share of associates	(172)	(475)	(475)	(475)
APAT	15,277	15,465	21,452	25,927

Balance Sheet

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Sources of Funds				
Equity Capital	1,611	1,613	1,613	1,613
Minority Interest	3,320	2,943	2,943	2,943
Reserves & Surplus	148,511	156,018	174,560	197,577
Net Worth	150,123	157,630	176,172	199,189
Total Debt	43,162	28,164	26,164	23,164
Net Deferred Tax Liability	17,543	17,911	16,442	16,625
Total Capital Employed	214,147	206,648	221,721	241,921

Applications of Funds

Net Block	66,774	63,019	59,037	53,310
CWIP	36,072	42,056	42,056	42,056
Investments	5,625	6,461	6,461	6,461
Current Assets, Loans & Advances	131,163	125,090	143,495	168,760
Inventories	39,648	43,776	49,003	49,548
Receivables	41,507	38,913	42,157	44,788
Cash and Bank Balances	6,188	10,039	18,013	38,512
Loans and Advances	11,938	13,307	14,165	14,865
Other Current Assets	10,623	8,890	9,992	10,881
Less: Current Liabilities & Provisions	25,486	29,978	29,328	28,666
Payables	19,480	22,818	21,277	20,717
Other Current Liabilities	6,006	7,160	8,051	7,948
<i>sub total</i>				
Net Current Assets	105,677	95,112	114,167	140,094
Total Assets	214,147	206,648	221,721	241,921

E – Estimates

Important Ratios

Particulars	FY19A	FY20A	FY21E	FY22E
(A) Margins (%)				
Gross Profit Margin	64.6	65.0	65.1	65.6
EBIDTA Margin	18.9	18.7	20.7	21.7
EBIT Margin	10.8	11.9	14.4	15.5
Tax rate	27.4	29.0	28.0	26.0
Net Profit Margin	9.3	9.0	11.2	12.5
(B) As Percentage of Net Sales (%)				
COGS	35.4	35.0	34.9	34.4
Employee	17.5	17.7	17.2	17.6
Other	28.3	28.6	27.2	26.4
(C) Measure of Financial Status				
Gross Debt / Equity	0.3	0.2	0.1	0.1
Interest Coverage	10.5	10.3	21.0	34.9
Inventory days	88	93	94	87
Debtors days	93	83	81	79
Average Cost of Debt	4.0	5.5	4.8	3.8
Payable days	43	49	41	36
Working Capital days	236	203	218	246
FA T/O	2.5	2.7	3.2	3.9
(D) Measures of Investment				
AEPS (Rs)	18.9	19.2	26.6	32.2
CEPS (Rs)	35.4	33.8	41.5	47.9
DPS (Rs)	3.5	8.2	0.0	3.6
Dividend Payout (%)	18.6	42.9	0.0	11.2
BVPS (Rs)	186.2	195.5	218.5	247.1
RoANW (%)	10.4	10.1	12.9	13.8
RoACE (%)	8.1	8.3	10.6	11.5
RoAIC (%)	8.9	10.0	13.8	15.9
(E) Valuation Ratios				
CMP (Rs)	729	729	729	729
P/E	38.5	38.0	27.4	22.7
Mcap (Rs Mn)	587,474	587,474	587,474	587,474
MCap/ Sales	3.6	3.4	3.1	2.8
EV	603,190	595,434	585,460	561,961
EV/Sales	3.7	3.5	3.1	2.7
EV/EBITDA	19.5	18.6	14.8	12.5
P/BV	3.9	3.7	3.3	2.9
Dividend Yield (%)	0.5	1.1	0.0	0.5
(F) Growth Rate (%)				
Revenue	7.5	4.7	11.5	8.8
EBITDA	9.6	3.5	23.3	13.9
EBIT	17.8	14.7	35.6	17.3
PBT	24.5	4.8	36.5	17.4
APAT	7.8	1.2	38.7	20.9
EPS	7.8	1.2	38.7	20.9

Cash Flow

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
CFO	18,847	33,633	18,820	34,241
CFI	(18,072)	(2,559)	(7,580)	(7,000)
CFF	(4,242)	(27,224)	(3,266)	(6,742)
FCFF	774	31,075	11,240	27,241
Opening Cash	9,656	6,188	10,039	18,013
Closing Cash	6,188	10,039	18,013	38,512

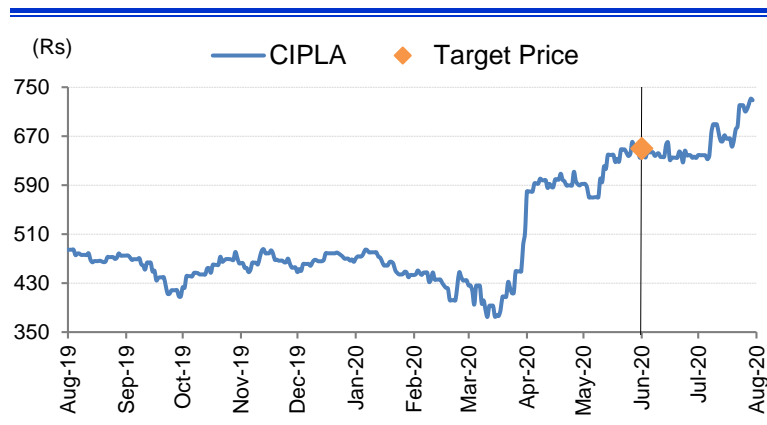
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
Jun-20	Accumulate	650	640

*Price as on recommendation date

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