Cipla Limited

Hale and Hearty Q2

Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Pharmaceuticals	Sharekhan code: CIPLA	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 790**	
Price Target: **Rs. 950**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

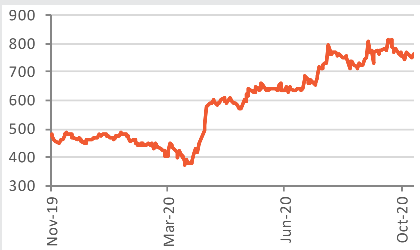
Company details

Market cap:	Rs. 63,695 cr
52-week high/low:	Rs. 829 / 357
NSE volume: (No of shares)	75.6 lakh
BSE code:	500087
NSE code:	CIPLA
Free float: (No of shares)	51.1 cr

Shareholding (%)

Promoters	36.7
FII	20.9
DII	19.7
Others	22.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.2	8.0	33.4	64.4
Relative to Sensex	-4.6	-2.2	1.2	60.9

Sharekhan Research, Bloomberg

Summary

- Cipla Limited (Cipla) ended Q2FY21 on a strong note as numbers beat estimates
- The one-India strategy, sustained traction in Chronics, revival in the acute therapy and covid related opportunities would fuel the growth in India revenues.
- Expected traction in new launches, healthy product pipeline to drive US sales while South Africa business is also expected to sustain strong growth momentum.
- Strong earnings visibility, and a healthy balance sheet augur well and would be key positives We maintain our Buy recommendation on the stock with a revised PT of Rs. 950.

Cipla Limited (Cipla) reported strong results for Q2FY2021 and numbers were ahead of estimates. The strong performance for the quarter was led by a sturdy performance of the India business and cost-optimisation measures implemented, leading to margin expansion. Revenue for the quarter at Rs. 5,038 crore grew by 14.6% y-o-y, backed by sturdy 17% y-o-y growth in India business. The surge in chronic therapies, Covid-19 led opportunities, and improvement in the hospital business resulted in strong growth for India business. Operating profit margin (OPM) expanded by 270 bps y-o-y to 23.4%, led by cost-optimisation measures implemented by the company. Operating profit increased by 29.4% y-o-y to Rs. 1,177 crore. Tracking the operating performance, PAT at Rs. 665 crore grew by 41.2% y-o-y and was ahead of estimates. Cipla's domestic business is poised to grow sturdily and would be a key contributor to the company's growth. Cipla's One-India strategy (wherein it merged all three business of prescription, trade generics, and consumer health to reap synergies) has played out well and would drive the growth momentum upwards. Sustained traction in chronics and market leadership position in therapies of respiratory, inhalation, and urology segments bode well. This coupled with likely recovery in the acute therapy and improvement in the hospital business would drive India business. Expected traction in new launches in the US and a healthy pipeline would drive the revenues for the US business. The South Africa business is also expected to sustain the strong double-digit growth momentum. In addition, Cipla is expected to benefit from COVID-related opportunities in India as well as in emerging markets. We expect Cipla's topline and PAT to report a CAGR of 11% and 31%, respectively, over FY2020-FY2023E. Moreover, management is working closely with USFDA to resolve issues at its Goa plant (OAI indicated by the USFDA) and has submitted its responses to regulator.

Key positives

- India revenue grew by 17% y-o-y backed by healthy growth in chronics and Covid-related opportunities, which offset growth in the acute segment.
- South African business recorded strong 25% y-o-y growth and is on a strong footing.
- Cost-optimisation measures resulted in OPM expansion of 270 bps y-o-y to 23.4%.

Key negatives

- Gross margin contracted by 490 bps y-o-y due to unfavorable mix.

Our Call

Valuation - Maintain Buy with a revised PT of Rs. 950: Cipla's One-India strategy has played out well and has yielded synergies across its business. Increased prescription generation backed by sustained traction in chronics, covid related opportunities and likely revival in acute therapy would drive growth of India business. The other business of US and South Africa are on a strong footing and are expected to report healthy growth backed by new launches and growth in the base business. Q2FY2021 was a strong quarter with margin expanding sturdily on account of cost-optimisation efforts. Based on this, we have revised upwards our estimates for FY2021/FY2022 by 5% and 1%, respectively, while we have introduced FY2023 estimates in this note. We expect Cipla's revenue and PAT to post an 11% and 31% CAGR over FY2020-FY2023, respectively. Currently, the stock is trading at a valuation of 22.7x/18.9x its FY2022/FY2023E 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 be key positives. We maintain our Buy recommendation on the stock with a revised PT of Rs. 950.

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.

Valuations (Consolidated) Rs cr

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2022E
Net sales	16362.4	17132.0	18714.4	20838.1	23349.9
Operating profit	3573.9	3550.2	4572.2	5162.3	5955.5
OPM (%)	18.9	18.7	22.5	22.9	23.7
Reported PAT	1492.4	1499.5	2343.9	2801.8	3375.5
EPS (Rs.)	18.7	19.2	29.1	34.8	41.9
PER (x)	42.2	41.2	27.2	22.7	18.9
EV/EBIDTA (x)	22.0	20.7	15.5	13.4	11.2
P/BV (x)	4.2	4.0	3.6	3.1	2.7
ROCE (%)	11.1	11.6	16.3	17.5	19.0
RONW (%)	10.3	10.1	13.9	14.6	15.3

Source: Company; Sharekhan estimates

Strong performance; Cost-control measures drive margin expansion: Cipla reported strong performance for Q2FY2021, with results beating ours as well street estimates. Revenue grew by 14.6% y-o-y to Rs. 5,038 crore and is ahead of estimates. Topline growth was led by sturdy 17% y-o-y growth in the Indian business, while US revenue increased by 10% y-o-y. Among other geographies, South Africa, Sub Saharanand the Global Access (SAGA) revenue grew by sturdy 25% y-o-y. During the quarter, Cipla outperformed the market growth in the Indian and South Africa markets. OPM for the quarter grew by 270 bps y-o-y to 23.4%. The margin expansion can be attributed to cost-control measures being implemented, which fully offset the impact of 490 bps decline in gross margin (due to unfavourable mix). Operating profit for the quarter stood at Rs. 1,177 crore, up 29.4% y-o-y. Tracking the operating performance, adjusted PAT stood at Rs. 665 crore, up 41.2% y-o-y and was comfortably ahead of estimates.

Domestic business traction to improve: India business accounts for around 40% of the company's overall sales. Revenue from India business for the quarter stood at Rs. 2,090 crore, up 17% y-o-y. Growth was primarily led by prescriptions business (up 14% y-o-y) because of sustained traction in the chronics portfolio. The hospital business also showed signs of improvement along with growth in COVID-19 related portfolio. Collectively, these offset the impact of the weak performance of the acute portfolio. Going ahead, Cipla expects traction in the India business to sustain. Cipla's 'One-India strategy' has played out well with the benefits being reflected in improved OPM. Under the One-India strategy, management has successfully merged three segments (Trade + Prescription+ OTC) in India business to leverage the existing product portfolio and distribution reach. With the strategy in place, management is looking at strong growth momentum for India business. This coupled with the company's strong position in the chronic segments of respiratory, inhalation, and urology would help the company post strong growth. On-ground activity is resuming and is expected to improve, which would drive growth in the prescription as well as aid the acute segment's revival. Overall, management is confident of sustaining strong growth trajectory and expects to continue outperforming the markets.

Q2FY2021 Conference call highlights

- **Regulatory updates:** Cipla's Goa plant is classified as an OAI by the USFDA. The company has submitted its responses to the regulator and is awaiting a response on the same from the regulator.
- **South African business:** The South African business, which includes South Africa, sub-Saharan, and global access grew by 14% y-o-y in local currency terms and has outperformed the market. Strong growth is driven largely by new launches. In the region, private business grew by 9% y-o-y, while the tender business grew by 28% y-o-y. Cipla has a market share of 7.2% in South African markets. Cipla has also partnered with Alvotech for commercialisation of five biosimilar candidates, which are in the immunology and oncology space.
- **North America:** Revenue grew by 10% y-o-y to Rs. 1,049 crore for the quarter. Growth can be attributed to traction in new launches – Albuterol, Esomeprazol oral suspension, and DHE nasal spray. During the quarter, the company launched dimethyl fumarate DR capsules in US markets. With the launch of new products and the same attaining traction, profitability of the US business has improved over time and is now close to the company's profitability.
- **Emerging markets:** The emerging market business reported growth of 5% y-o-y, driven by continued growth across all regions. Moreover, the company commenced supplies of Remdesivir across most of emerging markets.
- **R&D:** R&D spends stood at Rs. 226 crore, at 4.5% of sales. Management expects R&D spends to sustain around similar levels. However, over the period, R&D spend could inch up closer to 6%-7% of sales.

Results Rs cr

Particulars	Q2FY2021	Q2FY2020	YoY %	Q1FY2021	QoQ %
Net sales + OOI	5038.3	4395.8	14.6	4346.2	15.9
Operating profit	1176.6	909.5	29.4	1048.7	12.2
Other income	53.5	100.5	-46.8	65.5	-18.3
EBIDTA	1230.0	1010.0	21.8	1114.2	10.4
Interest	39.3	46.1	-14.6	46.0	-14.5
Depreciation	265.1	283.0	-6.3	269.0	-1.5
PBT	925.7	681.0	35.9	799.2	15.8
Tax	263.8	200.6	31.5	227.8	15.8
Adjusted PAT	665.4	471.4	41.2	577.9	15.1
			bps		**bps**
OPM (%)	23.4	20.7	266	24.1	-78

Source: Company; Sharekhan Research

Geographical Sales Break-Up – Quarterly Rs cr

Geography Mix (Rs. cr)	Q2FY2021	Q2FY2020	YoY %	Q1FY2021	QoQ %
India (Rx+Gx)	2090	1789	16.8	1608	30.0
North America	1049	953	10.1	1021	2.7
SAGA	924	740	24.9	763	21.1
EM	474	451	5.1	457	3.7
Europe	247	190	30.0	240	2.9
API	189	157	20.4	184	2.7
Others	66	116	-43.1	73	-9.6
Total	**5039.0**	**4396.0**	**14.6**	**4346.0**	**15.9**

Source: Company; Sharekhan Research

Outlook and Valuation

- **Sector View: Growth momentum to improve:** Indian pharmaceutical companies are better placed to harness opportunities and post healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in the US generics market), rise in product approvals, and plant resolutions by the USFDA coupled with strong growth prospects in domestic markets and emerging opportunities in the API space would be key growth drivers. This would be complemented by strong capabilities developed by Indian companies (leading to a shift towards complex molecules and biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this points towards a strong growth potential going ahead for pharma companies.

- **Company outlook - Gaining traction:** Cipla's domestic business is expected to be a key contributor towards the company's growth. A solid presence in the chronics segment along with market leadership position in select chronic therapies such as – respiratory, inhalation, and Urology bodes well for the company. Moreover, increased hospital orders and likely improvement in the acute therapy segment would fuel growth. The One-India strategy implemented by Cipla has played out well and is expected to result in strong growth momentum. Backed by a strong product launch pipeline, the US business is expected to report healthy growth, with Albuterol being a key growth driver. Moreover, businesses across other geographies are well set to capitalise on the upcoming opportunities and are likely to gain traction. Cost-optimisation measures implemented by the company in the near term are expected to sustain going ahead as well, leading to an improvement in margin trajectory.

- **Valuation - Maintain Buy with a revised PT of Rs. 950:** Cipla's One-India strategy has played out well and has yielded synergies across its business. Increased prescription generation backed by sustained traction in chronics and likely revival in the acute therapy would drive growth of the India business. Other business of US and South Africa are also on a strong footing and are expected to report healthy growth backed by new launches and growth in base business. Q2FY2021 was a strong quarter with margins expanding sturdily on account of cost optimisation efforts. Based on this, we have revised upwards our estimates for FY2021/FY2022 by 5% and 1%, respectively, while we have also introduced FY2023 estimates in this note. We expect Cipla's revenue and PAT to report at an 11% and 31% CAGR, respectively, over FY2020-FY2023. Currently, the stock is trading at a valuation of 22.7x/18.9x its FY2022/FY2023E 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 be key positives. We maintain our Buy recommendation on the stock with a revised PT of Rs. 950.

One-year forward P/E (x) band

Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Cipla	790.0	80.6	63695.0	41.2	27.2	22.7	20.7	15.5	13.4	10.1	13.3	14.5
Lupin	916.0	45.3	41538.0	117.7	33.3	25.8	19.9	14.2	11.0	2.8	9.0	10.5

Source: Company, Sharekhan estimates

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 setting up own front-ends to drive growth.

Investment theme

Cipla's domestic business is expected to be a key contributor towards the company's growth. A solid presence in the chronics segment along with market leadership position in select chronic therapies such as – respiratory, inhalation, and Urology bodes well for the company. Moreover, increased hospital orders and likely improvement in the acute therapy segment would fuel growth. The One-India strategy implemented by Cipla has played out well and is expected to result in strong growth momentum. Backed by a strong product launch pipeline, the US business is expected to report healthy growth, with Albuterol being a key growth driver. Moreover, businesses across other geographies are well set to capitalise on the upcoming opportunities and are likely to gain traction.

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

Dr Y K Hamied	Chairman
Mr M K Hamied	Vice Chairman
Ms Samina Hamied	Executive Vice-Chairperson
Mr. Umang Vohra	Managing Director & Global Chief Executive Officer
Mr. Kedar Upadhye	Global Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	4.24
2	ICIC Preudential Asset Management Co	3.7
3	First State Investments ICVC	3.12
4	SBI Fund Management	2.65
5	HDFC Asset Management	2.25
6	GOVERNMENT PENSION FUND - GLOBAL	1.65
7	Vanguard Group Inc/The	1.43
8	BlackRock Inc	1.21
9	Reliance Capital Trustee Company	1.17
10	Norges Bank	1.16

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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by BNP PARIBAS

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