Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

# Cadila Healthcare Ltd

## On a healthy growth path; Price correction provides an opportunity

| Pharmaceuticals | | Sharekhan code: CADILAHC | | |
|---|---|---|---|---|
| Reco/View: Buy | ↔ | CMP: **Rs. 458** | Price Target: **Rs. 720** | ↔ |

↑ Upgrade ↔ Maintain ↓ Downgrade

**3R MATRIX**

| | + | = | - |
|---|---|---|---|
| Right Sector (RS) | ✓ | | |
| Right Quality (RQ) | ✓ | | |
| Right Valuation (RV) | | ✓ | |

\+ Positive = Neutral – Negative

**What has changed in 3R MATRIX**

| | Old | | New |
|---|---|---|---|
| RS | | ↔ | |
| RQ | | ↔ | |
| RV | | ↔ | |

**ESG Disclosure Score** NEW

ESG RISK RATING 41.35

Updated Oct 08, 2021

Severe Risk

| NEGL | LOW | MED | HIGH | SEVERE |
|---|---|---|---|---|
| 0-10 | 10-20 | 20-30 | 30-40 | 40+ |

*Source: Morningstar*

**Company details**

| | |
|---|---|
| Market cap: | Rs. 46,898 cr |
| 52-week high/low: | Rs. 674 / 408 |
| NSE volume: (No of shares) | 25.2 lakh |
| BSE code: | 532321 |
| NSE code: | CADILAHC |
| Free float: (No of shares) | 25.7 cr |

**Shareholding (%)**

| | |
|---|---|
| Promoters | 74.9 |
| FII | 4.4 |
| DII | 11.3 |
| Others | 9.45 |

**Price chart**


**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | -3.2 | -15.9 | -28.7 | -6.0 |
| Relative to Sensex | -4.5 | -12.9 | -38.5 | -28.3 |

*Sharekhan Research, Bloomberg*


**Summary**

- Cadila Healthcare Limited's (Cadila) domestic business is on a strong footing to stage double-digit growth going ahead driven by strong show across domestic formulations and consumer wellness segments.
- Cadila's COVID portfolio comprising vaccines and drugs is also expected to add to the growth of the domestic business, in the light of emerging new variant of concern – Omicron.
- Though US business is currently impacted by higher competitive pressures, growth prospects over the medium to long term stay bright backed by strong new product pipeline comprising products in the limited competition space.
- We reiterate Buy recommendation on the stock with an unchanged PT of Rs. 720. Over the past five months stock price has corrected by ~28% and this provides a good opportunity for investors.


**Cadila Healthcare Limited's (Cadila) domestic business is on a strong footing to stage double-digit growth going ahead, backed by strong performance across domestic formulations and consumer wellness segments. Moreover, likely traction across the COVID-19 portfolio, which includes drugs as well as vaccines would complement domestic revenue growth. Though the US business is currently impacted by higher competitive pressures, growth prospects over the medium to long term stay bright backed by strong new product pipeline comprising products in the limited competition space. Over a span of 3-4 years, Cadila's emphasis on building a strong franchise for specialty/injectables and growing the same to $250 million bodes well and provides ample visibility on growth ahead.**

- **Domestic business to sustain double-digit growth trajectory:** Cadila's domestic business comprising formulations and consumer wellness business is set to report double-digit growth. Growth in the base business, market share gains in existing therapy areas, new launch pipeline to drive formulations segment sales, while increasing distribution reach, traction in existing and new brands are the key drivers for consumer wellness business. Cadila's COVID portfolio comprising vaccines and drugs is also expected to complement and add to the growth of the domestic business, given the recent spike in COVID cases and emerging new variant of concern – Omicron.
- **Emphasis to build a strong specialty/injectable franchise:** Cadila over the next 3-4 years is looking to build a strong franchise of complex injectables portfolio and specialty products. The company aims to build and grow the injectables franchise to around $250 million. Overall, a slew of new product launches lined up, including products such as – Saroglitzar (with an orphan drug designation), Desidustat, Novel drug compound ZY-19489 with Orphan drug designation coupled with few products in the specialty segment / 505 (b) (2) route, provide ample visibility on the growth ahead.
- **Strong product pipeline to drive US sales over the medium to long term:** Though Cadila's US business is passing through challenges in the form of heightened competitive intensity, but over the long-term growth prospects are bright. Growth would be backed by strong product launch pipeline, including new chemical entities (NCEs), specialty products, including injectables to be launched over the next two years. Moreover, in FY2021, it has launched 30 new products in the US and has plans to launch 20 more products in FY2022, excluding the ones filed from Moraiya plant. We believe the strong launch momentum could enable Cadila to maneuver competitive pressures partly. Cadila has also submitted its responses to USFDA for Moraiya plant and is awaiting a reply on the same. If cleared by the USFDA, it could enable Cadila to increase the new launch momentum.

**Our Call**

**Valuation: Reiterate Buy with an unchanged PT of Rs. 720:** Cadila's India business, backed by strong growth in formulations as well as consumer wellness segments, is set to report double-digit growth ahead. Further, expected traction from COVID portfolio, which includes drugs and vaccines would also complement India business growth, in the light of emerging new variant of concern – Omicron. The US business though currently is confronting challenges but growth prospects over the medium to long term stay bright. Going ahead, focus on building a strong injectables franchise and focus on IP-driven products would be key growth drivers for Cadila. At the CMP, the stock trades at 20.4x/17.1x its FY2022E and FY2023E EPS; and in the recent five months, the stock price has corrected by ~28%, thus providing a good opportunity for investors. We reiterate our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 720.

**Key Risks**

1) Price erosion in the US generics business could hurt performance; 2) A delay in resolution of USFDA issues at Moraiya plant; and 3) Forex volatility could affect earnings.

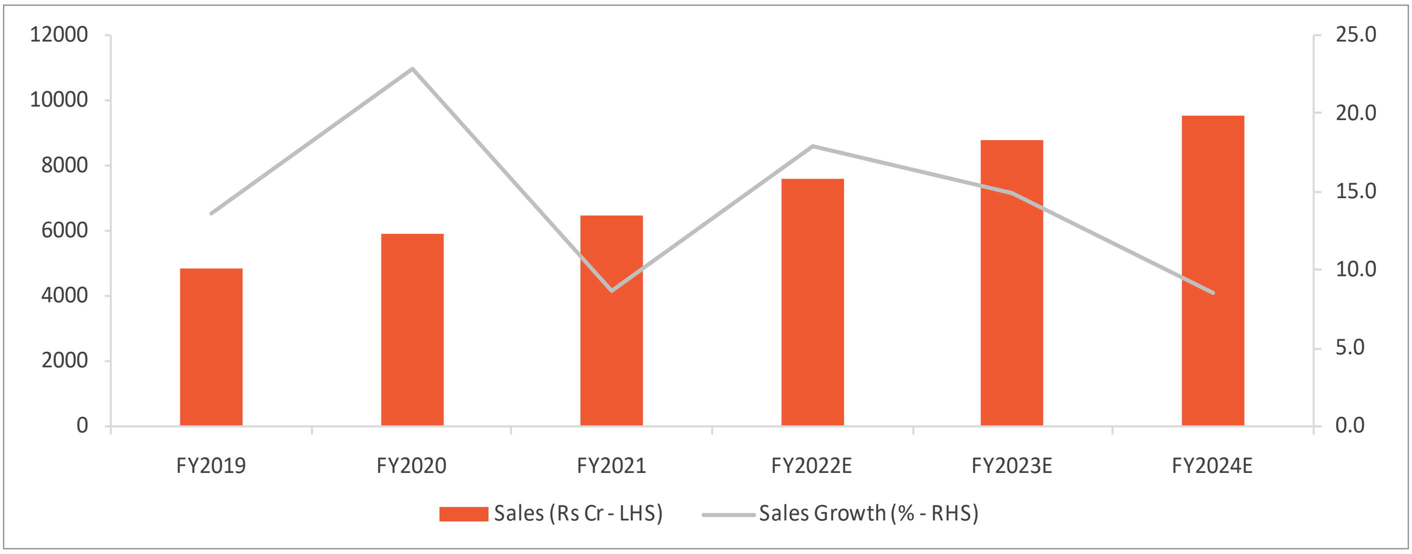
**Valuation (Consolidated)** Rs cr

| Particulars | FY21 | FY22E | FY23E | FY24E |
|---|---|---|---|---|
| Net sales | 15,102.2 | 16,239.5 | 18,008.9 | 19,491.0 |
| Operating Profit | 3,341.0 | 3,656.4 | 4,217.0 | 4,623.4 |
| OPM (%) | 22.1 | 22.5 | 23.4 | 23.7 |
| Adjusted Net profit | 2,291.3 | 2,297.1 | 2,761.0 | 2,931.2 |
| EPS (Rs.) | 22.4 | 22.4 | 27.0 | 28.6 |
| PER (x) | 20.5 | 20.4 | 17.1 | 16.0 |
| EV/EBITDA (x) | 15.5 | 13.6 | 11.3 | 9.7 |
| P/BV (x) | 3.6 | 3.2 | 2.8 | 2.4 |
| RoCE (%) | 12.8 | 14.9 | 16.0 | 15.8 |
| RoNW(%) | 17.6 | 15.6 | 16.4 | 15.3 |

*Source: Company; Sharekhan estimates*

**Domestic business to sustain double-digit growth trajectory:** Cadila's domestic business, which comprises the formulations as well as the consumer wellness business reported strong double-digit growth of 21.5% y-o-y for 1HFY2022, driven largely by double-digit growth in the domestic formulations business. Going ahead, the domestic formulations business is expected to sustain strong growth traction. This would be driven by higher momentum in the overall base business across chronic and acute therapies. In addition, the company has gained market share in anti-diabetic and cardiovascular therapeutic areas, which is expected to sustain ahead as well. This coupled with the COVID-19 portfolio (including the vaccines and drugs) would also add to growth of the India business revenue. In addition to this, a strong new product launch pipeline offering a sizeable growth opportunity would be one of the growth drivers for India business. Overall, recovery in Indian pharmaceutical markets, benefit from growth in COVID-19 portfolio, and string of new product launches planned would facilitate growth. The consumer health business has also staged healthy double-digit growth in 1HFY2022 and, going ahead, is also well poised to grow in double digits backed by growth in existing brands and new/re-launched brands. The company's strong brand position and well-spread distribution reach and broadening of the product portfolio would be key growth drivers.

**India Business sales - Sales growth**

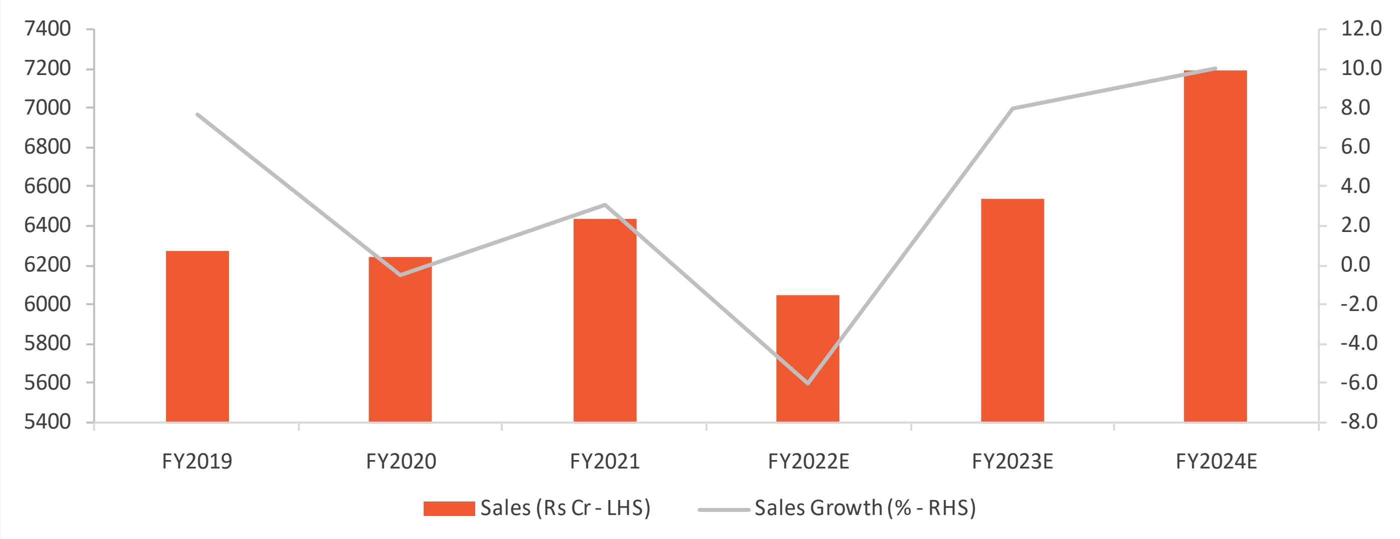



*Source: Company, Sharekhan Research*

**Emphasis to build a strong specialty/injectables franchise to fuel growth:** Cadila is looking to grow its complex injectables portfolio to around $250 million over the next 3-4 years. Regulators have granted Saroglitazar MG an 'Orphan Drug Designation'. The drug is indicated for treatment of patients with Primary Biliary Cholangitis (PBC). Currently, the drug is in clinical stages for PBC indication and the company looks to file by the end of CY2023. Saroglitzar MG is also being evaluated for NASH indication, but given the longer duration of trials, the filling date for NASH is likely to be FY2025-FY2026. In addition to this, Cadila is expected to begin the rolling submission for its specialty product, CUTX-101, by Q3FY2022 and being an orphan designated product, management expects the approval by CY2022-end or Q1CY2023. In addition to this, Cadila has a slew of products in various stages in the specialty segment/505 (b) (2) route, which have significant growth potential. Moreover, Cadila has received an Orphan Drug designation for its novel drug - ZY-19489, a compound drug to treat malaria. In the long term, focus on IP-driven products such as Saroglitazar and Desidustat and focus on injectables could be the key growth drivers for Cadila.

**Strong product pipeline to drive US sales over the medium to long term:** Cadila's US sales for 1HFY2022 declined by 12% y-o-y for 1HFY2022 attributable to heightened competitive intensity in US markets and this resulted in elevated price erosion. Going ahead, the company has a healthy outlook for the US. Growth would be backed by a strong product launch pipeline, which would include new chemical entities (NCEs) and specialty products including injectables to be launched over the next two years. Cadila has launched ~30 new products in the US in FY2021, which include complex injectable product as well. Further, in FY2022, the company looks to launch ~20 new products in the US and these would also include injectables. Further, in FY2023, subject to regulatory clearance of Moraiya plant, Cadila looks to launch 50 products. Cumulatively, excluding the Moraiya plant fillings, Cadila has a strong product pipeline for US markets and this bodes well. Cadila sees the US business to grow in single digits for FY2023, which is good considering existing pricing pressures.

**US business sales - Sales growth**

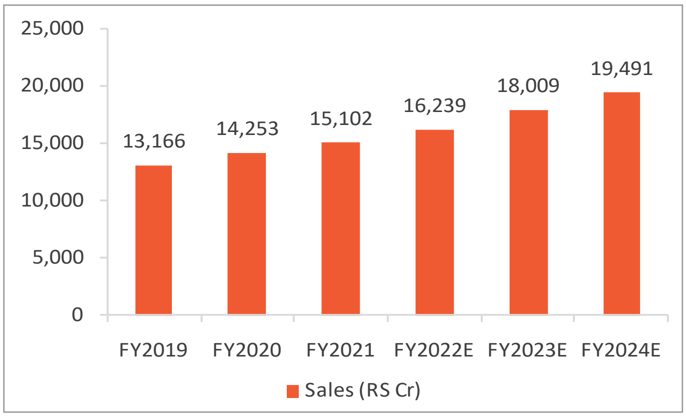



*Source: Company, Sharekhan Research*

**COVID-19 Vaccine Updates:** Cadila's COVID-19 vaccine ZyCoV-D, which is the first plasmid DNA vaccine had received an approval from the regulators for emergency use in India. Though the approval was received for adolescents in 12-18 years age group and for adult population, the vaccine currently is not part of the inoculation plan for children aged 15-17 years, but is available for adults aged 18 years and above. The Government of India has already ordered for 1 crore doses of the vaccine and Cadila would be supplying the same at a price of Rs. 358 per dose (including Rs. 93 for needle free applicator). Moreover, the company is conducting phase III trials for a two-dose regimen of the vaccine (currently the vaccine has a three-dose regimen) and for children in the age group of 5-12 years. Given the emergence of the new variants of concerns such as the Omicron, the Government of India has outlined its plans for precautionary doses for frontline healthcare workers, population with co-morbid conditions as well as for senior citizens also. Going ahead, in case of increased spread of the disease, the need for booster dose could arise. Moreover, in case the vaccine gets an approval for age group 5-12 years, it could open up substantial growth opportunities.

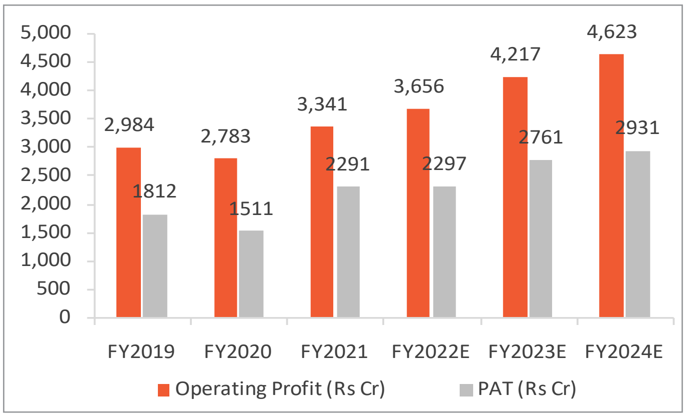
## Financials in charts

### Sales Trends



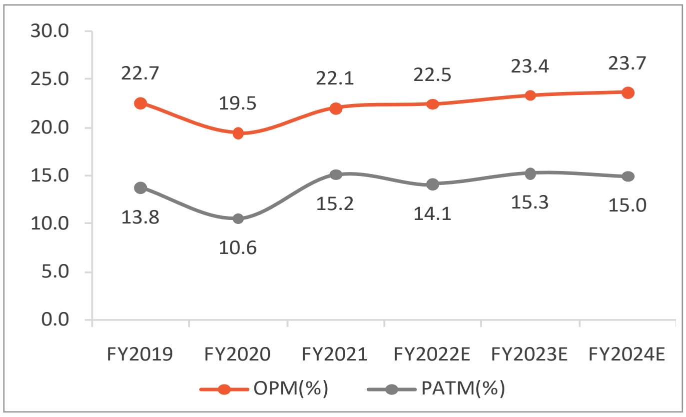

Source: Company, Sharekhan Research

### Operating Profit - PAT Trends



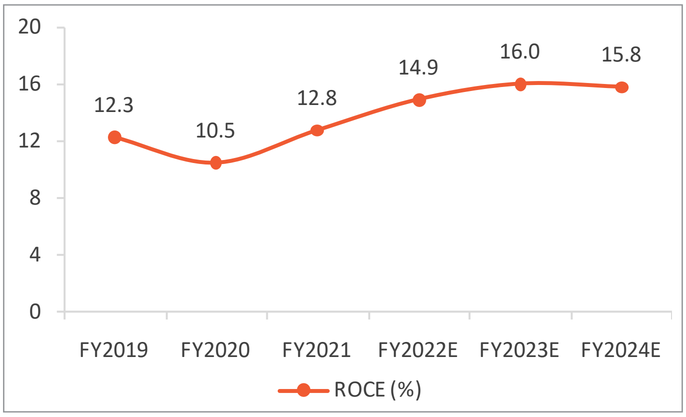

Source: Company, Sharekhan Research

### Margin Trends



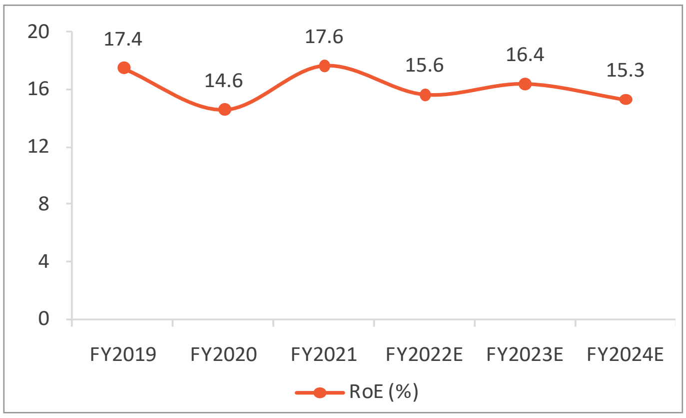

Source: Company, Sharekhan Research

### RoCE Trend (%)



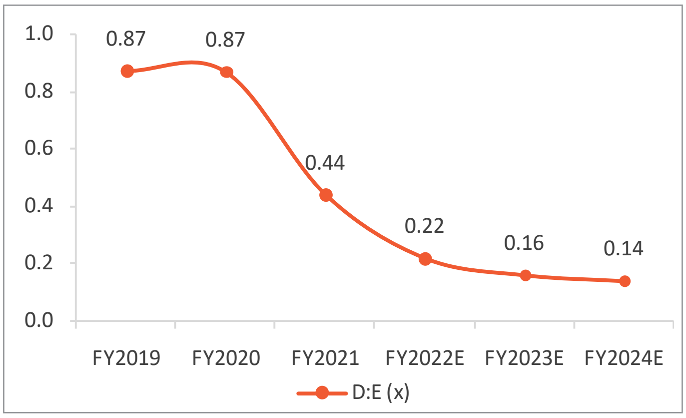

Source: Company, Sharekhan Research

### RoE Trends (%)




Source: Company, Sharekhan Research

### D:E




Source: Company, Sharekhan Research

## Outlook and Valuation

### ■ Sector view - Growth momentum to improve:

Indian pharmaceutical companies are better placed to harness opportunities and register 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), a 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 indicates a strong growth potential going ahead for pharmaceutical companies.

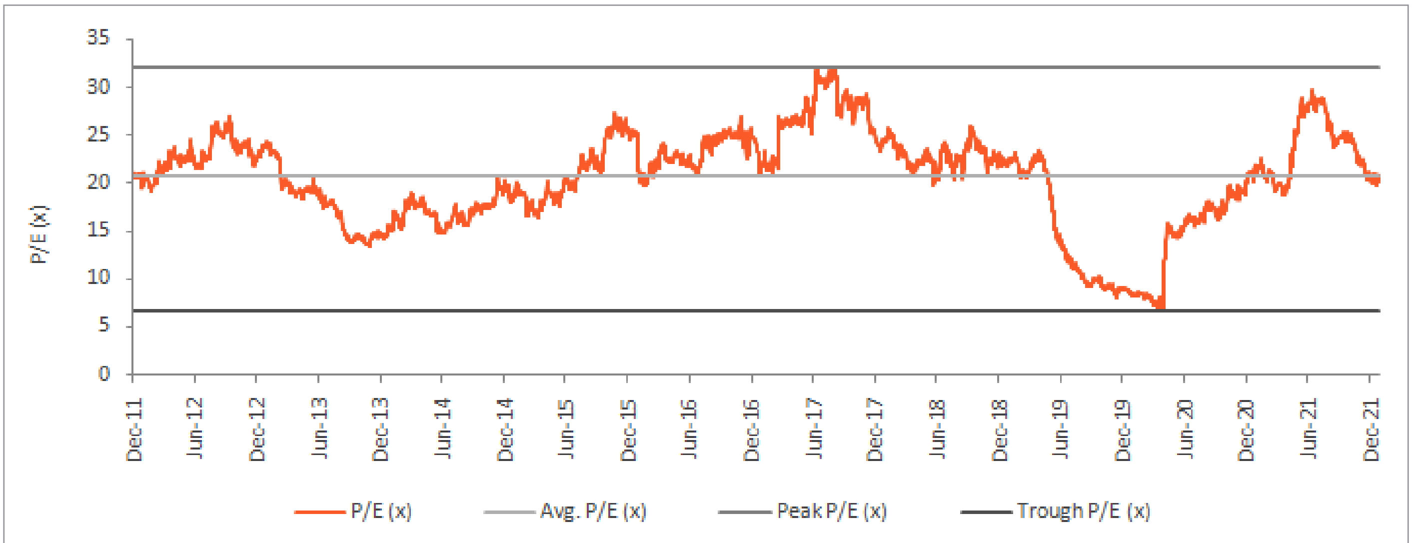
### ■ Company outlook - Healthy growth outlook

Cadila is getting in a sweet spot, wherein both geographies have an improved growth outlook. The US, which accounts for close to almost half its revenue, is on a strong footing helped by a sturdy new product pipeline and ramp-up in recent product launches, which would be key growth drivers. The efforts to build-up a presence in the injectables space would also add to growth albeit over the medium to long term. The India business is also showing signs of pick-up in growth momentum. Solid presence in the chronic and sub-chronic segments (which are key growth drivers for Indian pharmaceutical markets) and an improving outlook for the acute segment provide ample growth visibility. Over the long term, product launches such as Saroglitazar and Desidustat offer substantial growth potential. Further, opportunities from the COVID-19 vaccine are immense and provide a strong growth visibility. With substantial reduction in debt, Cadila has strengthened its balance sheet. Management looks to keep an eye on debt reduction going ahead as well. This augurs well and would go towards strengthening the financial muscle of the company. Strong earnings prospects, healthy return ratios, and strengthening balance sheet are key positives for Cadila.

### ■ Valuation - Reiterate Buy with an unchanged PT of Rs. 720

Cadila's India business, which accounts for ~44% of FY2021 sales, is on a strong footing to grow backed by double-digit growth in the domestic formulations as well as the consumer wellness segments. A strong new product launch pipeline, expected market share gains in existing therapy areas/products along with traction from the COVID-19 portfolio, including vaccines would support the domestic formulations growth. Expected growth in existing brands and new/re-launched brands and widening distribution network would fuel the consumer wellness segment's growth. Though high competitive pressures are impacting growth of the US business and long-term growth prospects are strong driven by sturdy product pipeline with a focus on specialty and complex generics products and traction in recent launches. Over the long term, IP-driven products and specialty products provide sizeable growth opportunities. At the CMP, the stock trades at 20.4x/17.1x its FY2022E and FY2023E EPS; and in the recent five months, the stock price has corrected by ~28%, thus providing a good opportunity for investors. Strong growth prospects and earnings visibility, a sturdy balance sheet, healthy return ratios, and multiple growth triggers are key positives for Cadila. Hence, we reiterate our Buy recommendation on the stock with an unchanged PT of Rs. 720.

**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 / EBITDA (x) | | | RoE (%) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | FY21 | FY22E | FY23E | FY21 | FY22E | FY23E | FY21 | FY22E | FY23E |
| Cadila Healthcare | 458.0 | 102.4 | 46,898.0 | 20.5 | 20.4 | 17.1 | 15.5 | 13.6 | 11.3 | 17.6 | 15.6 | 16.4 |
| Lupin | 917 | 45.3 | 41,636 | 34.2 | 27.9 | 20.5 | 17.8 | 12.6 | 9.5 | 8.8 | 10.0 | 12.2 |
| Dr Reddys | 4,743.0 | 16.6 | 78,934.0 | 40.3 | 28.6 | 22.6 | 16.0 | 14.7 | 12.0 | 11.1 | 14.4 | 16.4 |

*Source: Company, Sharekhan Research*

## About company

Cadila is one of the leading pharmaceutical companies in India. The company is present across the pharmaceutical value chain of research, development, manufacturing, marketing, and selling of finished dosage human formulations (generics, branded generics, and specialty formulations, including biosimilars and vaccines), active pharmaceutical ingredients (APIs), animal healthcare products, and consumer wellness products. The company has a global presence and sells its products in the US, India, Europe, and emerging markets, including countries in Latin America, Asia Pacific region, and Africa. The company is also engaged in research and development activities focused across the value chain of API process development, generics development for simple as well as differentiated dosage forms such as modified release oral solids, transdermals, topicals and nasals, biologics, vaccines, and new chemical entities (NCE).

## Investment theme

Cadila is favourably progressing in its efforts to build an alternative growth platform (NCE, biologics, and vaccines) that should start delivering over the medium to long term and reduce the company's dependence on limited competition assets in the US for its earnings. India business, including the consumer wellness segment, is likely to grow at a healthy pace, albeit over the medium to long term. Cadila is getting in a sweet spot, wherein both its geographies have an improved growth outlook. Easing pricing pressures, sturdy new product pipeline, and ramp-up in the recent product launches would be key growth drivers for the US business. Efforts to buildup presence in the injectables space would also add to growth albeit over the medium to long term. India business is also showing signs of pick-up in growth momentum, led by solid presence in the chronic and sub-chronic segments and an improving outlook for the acute segment. Further, COVID-19 related opportunities would add to the growth momentum.

## Key Risks

1) Regulatory compliance risk; 2) delay in product approvals; 3) currency risk; and 4) concentration risk in the US portfolio.

## Additional Data

**Key management personnel**

| | |
|---|---|
| Pankaj R. Patel | Chairman |
| Dr. Sharvil P. Patel | Managing Director |
| Mr. Ganesh Nayak | COO and Executive Director |
| Mr. Nitin Parekh | CFO |

*Source: Company*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | Life Insurance Corp of India | 3.3 |
| 2 | Kotak Mahindra Asset Management Co | 2.24 |
| 3 | GOVERNMENT PENSION FUND - GLOBAL | 1.18 |
| 4 | Norges Bank | 1.18 |
| 5 | UTI Asset Management Co | 0.83 |
| 6 | Vangaurd Group | 0.75 |
| 7 | Nippon Life Asset Management | 0.68 |
| 8 | Franklin resources | 0.48 |
| 9 | Fund Rock Management | 0.46 |
| 10 | ICICI Prudential Asset Management | 0.37 |

*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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