Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Cadila Healthcare Ltd

Steady Q3; India, Emerging markets to be growth drivers

Pharmaceuticals	Sharekhan code: CADILAHC
Reco/View: Buy ↔	CMP: **Rs. 408**	Price Target: **Rs. 560** ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We retain Buy Recommendation on Cadila Healthcare (cadila) with a revised PT of Rs 560. Given the steep 19% correction in stock prices in path three months the valuations now have turned reasonable.
- Q3FY22 was a steady quarter for Cadila with the revenues and PAT reporting a flat yoy growth. India growth(Ex-Covid products) was strong while US performance was under pressure.
- Management eyes a strong growth outlook for India, backed by market share gains in key therapy areas, planned launch of high value – Desidustat in April 2022 and growth in the base business
- The US business is expected to be impacted by price erosion in near term while long term growth levers are intact driven by planned high value launches.

Cadila Healthcare (Cadila) reported a steady performance for Q3FY22 and higher than anticipated other income and share of JV led to PAT marginally ahead of estimates. The growth was driven by a strong performance in the domestic formulations (adjusting for the Covid portfolio) while the US business remained under stress impacted by price erosion. The revenue and PAT at Rs 3655 cr and Rs 500 cr respectively were flat on a y-o-y basis. Going ahead, the management sees a robust outlook for the India and emerging markets while the US business is expected to be under stress in near term. Over the long term, prospects are bright driven by growth from IP driven products, biosimilars. While near term growth is expected to be slow for the US impacted by price erosion.

Key positives

- Excluding Covid products India formulations business reported a strong 17% y-oy-y growth.
- API sales grew by 23% y-o-y, while Europe sales grew by 11.5% y-o-y
- Management has implemented certain cost control measures and expects 80-100 BPS OPM expansion.

Key negatives

- US sales declined by 6% y-o-y because of pricing pressures, which also resulted in the 380 bps y-o-y decline in the gross margins.
- Delay in the plant inspection by USFDA for Moraiya.
- Moderation in the Covid vaccine opportunity, especially in domestic markets

Management Commentary

- Management eyes a strong growth outlook for India, backed by market share gains in key therapy areas, planned launch of high value – Desidustat in April 2022 and growth in the base business.
- Cadila's US business growth is expected to be impacted by high price erosion which is expected to sustain and management expects US sales to grow in low-mid single digits for FY23. However strong product pipeline for the US including specialty and injectables would be long term drivers.
- Cadila has commenced supplies of Zycov-D vaccine recently to the Government of India and has also entered in to tie up with Korean company to commercialize the vaccine in Korea, LatAm and Asian markets.

Revision in estimates – Q3FY22 was a steady quarter, but basis the moderation in opportunity for Vaccines and sustained pricing pressures in the US markets, we have revised downwards our estimates for FY22E and FY23E but have maintained FY24E earnings considering the strong growth prospects in US business.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 560: Cadila's growth prospects in the India as well as in emerging markets stay bright while that in the US markets are likely to moderate in the near term due to heightened pricing pressures. Further the vaccines opportunity in the domestic markets though has moderated, but the management is hopeful of healthy traction in exports markets. At the CMP, the stock trades at 19.3x/16.6x/14.1x its FY22E/FY23E and FY24E EPS. The stock price has corrected by 19% in the three months and the valuations now look reasonable. Basis the expected strong outlook for the India business and other Emerging Markets we retain Buy recommendation on the stock with revised PT of Rs. 560

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY2021	FY2022E	FY2023E	FY2024E
Net sales	15,102.2	15,621.6	17,031.6	19,078.4
Operating Profit	3,341.0	3,455.7	3,880.1	4,584.8
OPM (%)	22.1	22.1	22.8	24.0
Adjusted Net profit	2,291.3	2,166.4	2,516.9	2,956.9
EPS (Rs)	22.4	21.2	24.6	28.9
PER (x)	18.2	19.3	16.6	14.1
EV/EBITDA (x)	14.0	12.9	11.0	8.8
RoCE (%)	12.8	13.7	14.4	15.6
RoNW(%)	17.6	14.9	15.3	15.7

Source: Company; Sharekhan estimates

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 Jan 08, 2022

Severe Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 41,728 cr
52-week high/low:	Rs. 674 / 380
NSE volume: (No of shares)	60.7 lakh
BSE code:	532321
NSE code:	CADILAHC
Free float: (No of shares)	25.7 cr

Shareholding (%)

Promoters	74.9
FII	5.6
DII	11.3
Others	8.28

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-14.6	-16.9	-31.1	-14.8
Relative to Sensex	-13.9	-15.2	-40.4	-31.7

Sharekhan Research, Bloomberg

Steady quarter: Q3FY22 was a quarter with a steady growth for Cadila and higher than anticipated other income and share of JV led to PAT marginally ahead of estimates. The growth was driven by a strong performance in the domestic formulations business while the US business remained under stress. The revenues at Rs 3655 cr were almost flat (up 0.6% y-o-y). The domestic formulations business declined by 2.2% y-o-y while the USA declined 6% y-o-y due to pricing pressures. The domestic formulations business though declined by 2% y-o-y but excluding the contribution from the Covid portfolio the domestic formulations business posted an impressive growth of 17% y-o-y . The revenues were largely in line with the estimates. The operating margins at 20.6% (as against estimates of 21.6%) contracted by 50 bps y-o-y attributable to a gross margins contraction of 380 bps y-o-y , which was partly offset by savings in the other expenses and employee cost. The gross margins contraction is largely attributable to the pricing pressures in the US business and some increase in the input costs. The operating profits at 752.5 cr was down modestly by 2% YoY and missed estimates. The other income at Rs 60.8 cr sharply increased yoy as compared to Rs 27.2 cr (in Q3FY21). Also the share of JV and minority interest was up. Consequently, the adjusted PAT at Rs 500 cr was flat on a y-o-y basis, but was marginally ahead of ours and street estimates.

Q3FY2022 Conference Call Highlights:

- **Strong product pipeline to drive US sales over long term, near term growth to moderate:** US sales declined by 6% y-o-y to Rs.1504 crore, while sequentially, revenues were flat. During Q3FY22 Cadila witnessed heightened competitive intensity in the US markets and this resulted in elevated price erosion. Also, a decline in mesalamine products impacted the growth. Going ahead, over the long term the company sees healthy outlook for US. Growth would be backed by strong product launch pipeline, which would include new chemical entities (NCEs), specialty products including injectables to be launched over the next two years. During Q3 the company has launched 3 new products including Nelarabine injection for which it has a 180-day exclusivity. Further,over the next one year Cadila has lined up 2 potential high value launches apart from gRevlimid in the US markets. Further over the next year Cadila plans looks to launch 40 ANDA;s in the US markets subject to clearance of the Moraiya plant. Secondly in the past Cadila has launched ~30 new products in FY2021, coupled with a healthy momentum on 9MFY22. The new products launches are expected to ramp up going ahead and would aid top line growth. Cadila has also lined up few biosimilars to be launched in the US markets though the time lines are not known. Cumulatively, a strong product pipeline would enable Cadila offset the effect of price erosion, albeit substantial high value product launches are likely over the long term with material growth expected in FY2024. Cadila eyes a $1bn revenues from the US by FY2024 while the growth in the near term is expected to moderate. The management sees the US sales to grow in low to mid single digits for FY2023.
- **Focus to build a strong specialty / injectables franchise to fuel growth:** Cadila is looking to grow its complex injectables portfolio over the next 3-4 years. Cadila is in to clinical trails for Saroglitazar MG (Orphan Drug Designation from USFDA) for two indications - Primary Biliary Cholangitis (PBC) and NASH and expects Saroglitzar MG to be launched for PBC in US by 2025 while that for NASH indication is expected to be by 2027. In addition to this cadila has submitted NDA to DCGI for Desidustat for treatment oif anemia in patients with CKD. IN addition to this there are two other NCE's (ZY19489 and ZYIL1) which are in the pipeline. Apart for the NCE's Cadila is also building a peipline of biosimilars and Biologics space with pegfilgrastim getting approved in Russia and gradually being expanded to other geographies. Overall in the next 3 years the company expects 4 biosimilars to come up for approval, which could fuel the growth. Basis the approvals expected for biosimilars the company's eyes $40 mn revenues frm the biosimilars. Also Cadila has commenced rolling submission for its specialty product CUTX-101 and is expecting an approval for a module soon. 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. In the long term, focus on IP-driven products and focus on injectables could be the key growth drivers for Cadila.
- **Robust outlook for Domestic business backed by new launches:** Cadila's domestic formulations business recorded a marginal decline of 2.2% y-o-y for Q3 to RS 10749 cr. Adjusting for the Covid products the growth was strong at 17% y-o-y . The cosumer well ness segment however reported a modest growth of 1.6% y-o-y. Going ahead, domestic formulations business is expected to sustain the strong growth traction. This would be driven by a higher momentum in overall base business across chronic and acute therapies. In addition, the company has gained market share in anti-diabetic, cardiovascular therapeutic areas, which is expected to sustain ahead as well. Further Cadila plans to launch Desidustat in India markets by April 2022, which is a high value launch and the company is targeting for a 30% conversion of new as well as existing patients, which is positive. Also it had launched two biosimilars in the India markets in the previous year which could now ramp up. The company's strong brand position and well-spread distribution reach and broadening of the product portfolio would be key growth drivers for India business and management sees this as a key growth driver.

- **COVID Vaccine updates:** Cadila's COVID-19 vaccine ZyCoV-D has received an approval from the regulators for emergency launch in India. Approval was received for the adolescents in 12-18 years age group as well besides the adult population, making it the first vaccine for the adolescents. Cadila has current capacity of 1 crore doses a month of the vaccine and has tied up with one indian company to expand the production capacity. Recently it has commenced the supplies to the Government of India for its 1 cr doses order of the vaccine and the management expects the supplies to continue over the subsequent quarters up to Q1FY23. Also Cadila has tied up h Enzychem Lifesciences of South Korea to manufacture and supply the vaccine to local markets as well to Latin American and Aian countries. Overall possible opening of the vaccination drive for 12-15 years age group and Cadila's efforts to get approval for a 2 dose regimen and a possibility of a booster shot point at a demand traction for the vaccine.
- **Regulatory aspects:** Cadila has completed all CAPAs and has submitted its responses to the USFDA, which have been accepted by the agency. A revert from the regulator is awaited. Regulatory clearance for Moraiya plant could be a key growth driver for the company and once approved the management would be in a position to go ahead with the transdermal patches portfolio launch in the US, which are filed from Moraiya. The management is hopeful of an inspection of the Moraiya plant in the next 2-3 quarters.
- **Outlook:** Backed by a strong outlook, the management sees the India business grow in double digits for FY23 while the US revenues are expected to clock a modest low to mid-single digit growth in FY23. Sustained pricing pressures and a delayed new product launches would slow down the growth for the US. Further basis the sustained pricing pressures and escalation in costs, the gross margins are expected to be in 62-63% range for FY23. However, basis the substantial high value launches lined up and growth in the exiting business, FY24 is expected to clock an impressive growth, US revenues likely to touch $1bn

Result Consolidated Rs cr

Particulars	Q3FY2022	Q3FY2021	YoY %	Q2FY2022	QoQ%
Total Operating revenues	3,655.0	3,633.4	0.6	3,784.8	-3.4
Operating profit	752.5	766.9	-1.9	860.8	-12.6
Other Income	60.8	27.2	123.5	53.3	14.1
EBITDA	813.3	794.1	2.4	914.1	-11.0
Interest	31.1	27.1	14.8	30.1	3.3
Depreciation	183.2	176.2	4.0	184.8	-0.9
PBT	599.0	590.8	1.4	699.2	-14.3
Taxes	110.7	104.5	5.9	118.9	-6.9
PAT	488.3	486.3	0.4	580.3	-15.9
Reported PAT	500.4	501.0	-0.1	506.2	-1.1
Margins			**BPS**		**BPS**
OPM %	20.6	21.1	-51.9	22.7	-215.5
PATM %	13.7	13.8	-9.8	15.4	-171.4
Tax rate %	18.5	17.7	79	17.0	148.1

Source: Company; Sharekhan Research

Revenue Mix

Revenue break up (Rs Cr)	Q3FY2022	Q3FY2021	YoY %	Q2FY2022	QoQ%
India	1461.0	1480.0	-1.3%	1590.0	-8.1%
Human formulations	1079.0	1104.0	-2.3%	1213.0	-11.0%
Consumer Wellness	382.0	376.0	1.6%	377.0	1.3%
US Formulation	1504.0	1603.0	-6.2%	1498.0	0.4%
EM & LATAM Formulations	291	293	-0.7%	349	-16.6%
Europe Formulations	68	55	23.6%	61	11.5%
APIs	165	132	25.0%	134	23.1%
Alliances	56.0	19.6	185.7%	55.0	1.8%
Grand Total	**3545.0**	**3592.6**	**-1.0%**	**3687.0**	**-3.9%**
OOI	110.6	41.9	164.0%	97.8	13.1%
Total Operating revenues	**3655.6**	**3633.0**	**0.9%**	**3784.8**	**-3.4%**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – 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.

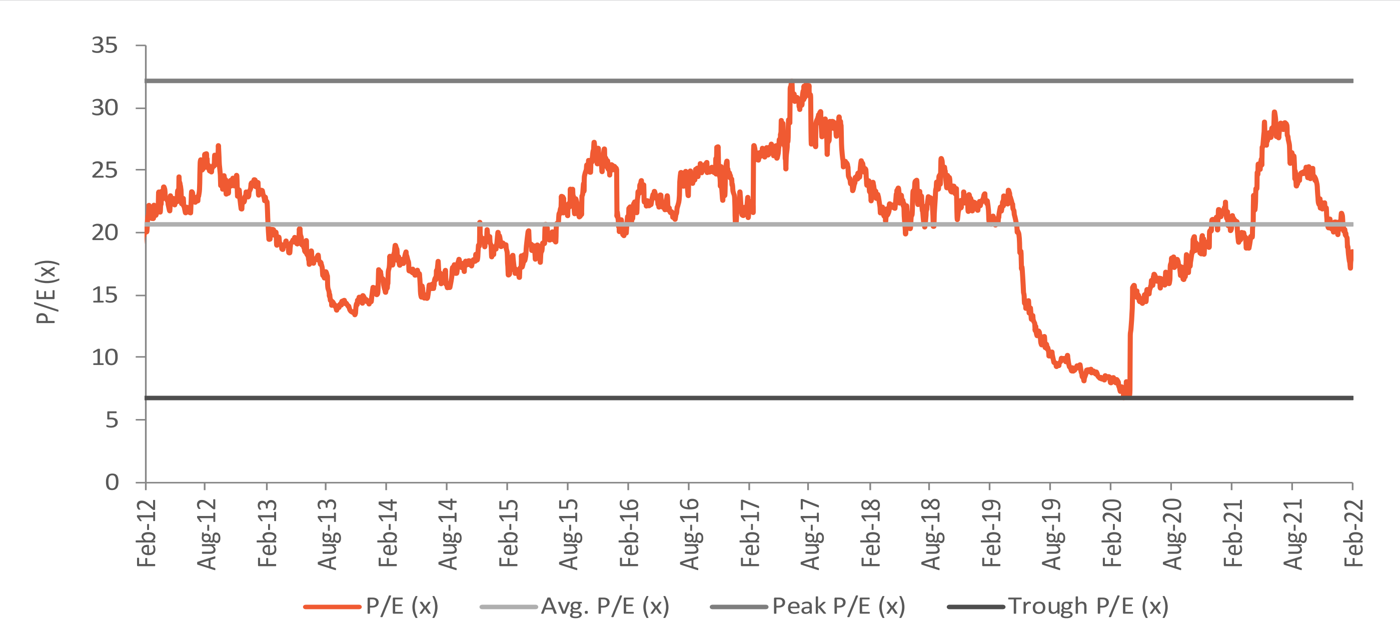
■ Company outlook – Healthy growth outlook

Over the long term both geographies – US and India have an healthy 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 long term growth drivers. However, in the near term high price erosion would act as dampeners. 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 has a robust growth outlook backed by a pickup in the chronic as well as acute therapies and a few substantial high value launches lined up. Over the long term, product launches such as Saroglitazar, gRevlimid and Desidustat offer substantial growth potential. Further, opportunities from the COVID-19 vaccine are also material and provide a visibility on growth. With substantial reduction in debt, Cadila has strengthened its balance sheet. The 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. While in the near term, US growth is expected to moderate while India and other geographies are likely to stage double digit growth.

■ Valuation – Retain Buy with Revised PT of Rs 560

Cadila reported a steady performance for Q3FY22, but the gross margins declined by 380 bps y-o-y due to the pricing pressures in the US markets and higher input costs. Going ahead the management sees the pricing pressures in the US to sustain while delayed re-inspection for the Moraiya could also act a dampener. Cadila sees the US growth to moderate in FY23 while the same is expected to bounce back impressively in FY24 with the management expecting a $1bn revenues from US. On the other hand the India business backed by growth in the existing business and new product launches is expected to stage a double digit growth in FY23. Further the Covid vaccines opportunities though has moderated, but the management is exploring opportunities in the exports markets and sees a healthy traction in the subsequent quarters. Over the long term, IP-driven products and specialty products provide sizeable growth opportunities. Q3FY22 was a steady quarter, but basis the moderation in opportunity for Vaccines and sustained pricing pressures in the US markets, we have revised downwards our estimates for FY22E and FY23E but have maintained FY24E earnings considering the strong growth prospects in US business. At the CMP the stock trades at 19.3X/16.6x/14.1x its FY22E/FY23E and FY24E. Basis the expected strong outlook for the India business and other Emerging Markets we retain Buy recommendation on the stock with revised PT of Rs. 560.

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	408.0	102.4	41,728.0	18.2	19.3	16.6	14.0	12.9	11.0	17.6	14.9	15.3
Lupin	900	45.3	40,913	33.6	27.4	20.1	17.5	12.3	9.2	8.8	10.0	12.2
Dr Reddy's	4,373.0	16.6	72,785.0	37.2	26.4	19.5	14.7	13.7	10.7	11.1	14.4	17.5

Source: Company, Sharekhan estimates

About the 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, transdermal, 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 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. The efforts to build up 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 & Executive Director
Mr. Nitin Parekh	CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	3.3
2	Kotak Mahindra Asset Management Co	2.2
3	GOVERNMENT PENSION FUND - GLOBAL	1.2
4	Norges Bank	1.2
5	UTI Asset Management Co	0.8
6	Vangaurd Group	0.8
7	Nippon Life Asset Management	0.7
8	Franklin resources	0.5
9	Fund Rock Management	0.5
10	ICICI Prudential Asset Management	0.4

Source: Bloomberg (Updated - 27 May 2021)

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

Sharekhan

by BNP PARIBAS

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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