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Cadila Healthcare Limited

Strong Quarter; Sturdy growth outlook

Pharmaceuticals	Sharekhan code: CADILAHC	Result Update

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

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 437**	
Price Target: **Rs. 530**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

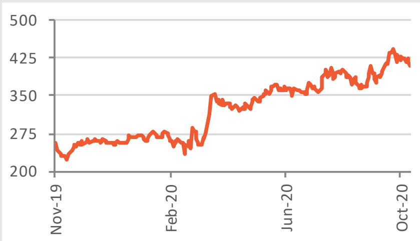
Company details

Market cap:	Rs. 44,784 cr
52-week high/low:	Rs. 451 / 213
NSE volume: (No of shares)	49.4 lakh
BSE code:	532321
NSE code:	CADILAHC
Free float: (No of shares)	25.7 cr

Shareholding (%)

Promoters	74.9
FII	4.7
DII	12.9
Others	7.54

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	9.9	10.7	35.0	71.3
Relative to Sensex	5.9	1.7	15.6	71.1

Sharekhan Research, Bloomberg

Summary

- Cadila Healthcare Limited (Cadila) reported strong results for the quarter with numbers ahead of estimates.
- Solid presence in the chronic and sub-chronic segments (which are the key growth drivers for Indian pharmaceutical markets) and an improving outlook for the acute segment provide ample growth visibility for India business
- Easing pricing pressures, sturdy new product pipeline, and ramp up in the recent product launches would be key growth drivers going ahead for the US business.
- Strong growth prospects, sturdy balance sheet, and healthy return ratios would support multiple re-ratings. We retain our Buy recommendation on the stock with a revised PT of Rs. 530.

Cadila Healthcare Limited (Cadila) reported strong results for the quarter with the numbers coming in ahead of estimates. Revenue for the quarter at Rs. 3,820 crore grew 13.5% y-o-y as the India business reported 11% y-o-y growth, led by market share gains in select therapies. Exports grew strongly by 20% y-o-y because of 18% growth in the US business. The API segment revenue grew sturdily by 52% y-o-y. Operating profit margin (OPM) for the quarter expanded by 400 bps y-o-y to 22.6%, attributable to savings in other expenses. Operating profit stood at Rs. 863 crore, up 38% y-o-y. Adjusted PAT at Rs. 605 crore grew by 61.18% y-o-y and was ahead of estimates. Cadila is getting in a sweet spot, wherein both its geographies have an improved growth outlook. The US, which accounts for close to almost half its revenues, is on a strong footing. Easing pricing pressures, sturdy new product pipeline, and ramp up in the recent product launches would be key growth drivers. Efforts to build up presence in the injectables space, which offers strong growth potential, would unfold over the medium to long term. The India business is also showing signs of pick up and management expects to sustain the growth momentum. Solid presence in the chronic and sub-chronic segments (which are the key growth drivers for Indian pharmaceutical markets) and an improving outlook for the acute segment provide ample growth visibility. Further, COVID-related opportunities would add to the growth momentum. Cadila has substantially reduced its debt in H1FY2021. This augurs well and would strengthen the financial muscle of the company.

Key positives

- US formulations business (forming ~45% of total revenue) reported strong growth of 18% y-o-y for a second consecutive quarter.
- India business reported double-digit 11% growth after a quarter of decline.
- OPM expanded by 400 bps y-o-y and is one of the highest margin expansions reported in the past 7-8 quarters.

Key negatives

- Delay in USFDA resolution of Moraiya plant.

Our Call

Valuation: Retain Buy with a revised PT of Rs. 530: Cadila reported a strong performance for Q2FY2021. Both the company's key segments, the US and INDIA, have staged double-digit growth and are expected to witness improved growth traction. Stabilising price erosion in US markets, a sturdy product pipeline with a focus on specialty and complex generics products would be the key positives. While in India, new launches, COVID-19 related opportunities and strategic restructuring of business would fuel growth. Recent new launches such as pressurised Metered Dose Inhaler – Forglyn in India is also expected to add to growth. Cadila is also developing a vaccine for COVID-19 and expects results from the trials by March – April 2021. If approved, this could unlock a sizeable growth opportunity. Further, Cadila has been able to substantially reduce its debt in H1FY2021. This coupled with strong margin expansion has resulted in an upward revision in FY2022/FY2023 earnings estimates by 6% and 4%, respectively. At the CMP, the stock trades at 21.3x/18.1x its FY2022/FY2023 estimates. Strong growth prospects and earnings visibility, a sturdy balance sheet, and healthy return ratios would support multiple re-ratings. We retain our Buy recommendation on the stock with a revised PT of Rs. 530.

Key Risks

- Elevated price erosion in the US generic business could hurt performance.
- Delay in resolution of the USFDA issues at Moraiya plant.
- Forex volatility could impact earnings.

Valuations (Consolidated) Rs cr

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Net sales	13,165.6	14,253.1	15,207.3	16,477.6	17,949.2
Operating Profit	2,983.5	2,783.4	3,274.9	3,577.5	4,043.7
OPM (%)	22.7	19.5	21.5	21.7	22.5
Adjusted Net profit	1,812.3	1,511.4	1,865.3	2,110.9	2,488.1
EPS (Rs.)	17.7	14.8	18.2	20.6	24.3
PER (x)	24.8	29.7	24.1	21.3	18.1
EV/EBITDA (x)	17.9	19.1	14.9	13.0	10.9
P/BV (x)	4.3	4.3	3.8	3.4	3.0
RoCE (%)	12.3	10.5	12.7	13.6	14.9
RoNW (%)	17.4	14.6	15.9	15.9	16.4

Source: Company; Sharekhan estimates

Q2FY2021 a strong quarter: Cadila reported strong results for the quarter. Earnings were better than estimates. Revenue for the quarter at Rs. 3,820 crore was up 13.5% y-o-y. India business reported growth of 11% y-o-y, led by market share gains in select therapies. Exports grew strongly by 20% y-o-y. Growth in exports markets was primarily led by sturdy 18% growth in US markets, led by strong demand traction. OPM for the quarter expanded by 400 bps y-o-y to 22.6%. A large portion of the margin expansion can be attributed to savings in other expenses (other expenses/sales declined by 270 bps y-o-y). Operating profit stood at Rs. 863 crore and recorded 38% growth y-o-y. The company reported an exceptional item of Rs. 132 crore premium on non-convertible debentures on their purchase by the group. Consequently, adjusted PAT at Rs. 605 crore grew by 61.18% y-o-y and was ahead of estimates.

New product launches and stabilising price erosion to lead to healthy growth in US business: Cadila's US business has reported strong 18% y-o-y growth for the quarter, backed by volume growth in existing products and new launches. This is the second consecutive quarter of double-digit growth reported by the US business. Management has stated that price erosion in US generics has largely stabilised (with the pace of price reduction having slowed). This augurs well for the company. Further, volumes are likely to grow at a steady pace, led by new launches. The company has done six new launches in the US during Q2FY2021 (in Q1FY2021, the company had done three launches). This also includes one product in the injectables space. Cumulatively, Cadila has launched two new products in the injectables space. Further, Cadila has a strong pipeline on the injectable space, which it expects to unfold in the next 3-4 years. Management sees an opportunity of ~$150mn-$200mn from this space, albeit material benefits are likely to come in over the long term. During the quarter, the company has received approval for 10 new ANDAs, including two tentative approvals. It has filed for five new products with the USFDA. Cadila has completed a site transfer to the Liva plant from Moraiya plant for few products and has filed an application for site transfer for the other two products. Therefore, given the strong pipeline of filings, steady volume growth, and reduction in price erosion, the US business offers better growth visibility.

Domestic business reports double-digit growth for the quarter: Cadila's domestic business has reported 11% y-o-y growth to Rs. 1,583 crore after a decline in the previous quarter. Growth can be attributed to 19.5% growth in the animal health business, while domestic formulations grew by 11% y-o-y, backed by market share gain in the gynecology, pain management, and anti-diabetes therapies amongst others. Going ahead, the domestic formulations business is expected to sustain the strong growth traction. This would be driven by a higher momentum in chronic and sub-chronic therapies, while acute therapies are likely to remain soft. The COVID-related portfolio is also expected to fuel growth for the domestic business. Cadila's version of Remdesivir is the lowest cost product in markets and offers a strong demand potential, given the increase in Covid-19 cases. Cadila is also exploring export opportunity for Remdesivir. The animal health business is also expected to report healthy growth. The company's strong brand position and well-spread distribution reach would enable growth. Moreover, faster revival of the rural sector and recovery in the poultry business would be key growth drivers for animal health business.

Q2FY2021 Conference Call Highlights

- **US business:** Cadila sees this business to sustain the growth traction backed by a sturdy pipeline of new launches and stabilising price erosion in the generic space. On the injectable front, the company is building a strong product pipeline, which would unfold gradually over the next few years. This would be key growth drivers, though over the long term.
- **India business:** After a weak performance in the past two quarters, Cadila's India revenue has reported 11% y-o-y growth for Q2FY2021. Traction in the domestic formulations business backed by pick-up in the animal health business would be key growth drivers for the company. Management is confident of sustaining the strong growth trajectory as COVID-19 related portfolio would add to the growth momentum.
- **Regulatory aspects:** Cadila is done with the remediation process at its Moraiya facility and has submitted updates/responses to the USFDA. The company has completed all the CAPAs and has submitted its responses to the USFDA. A revert from the regulator is awaited. Regulatory clearance for Moraiya plant could be a key growth driver for the company.

- **Product Fillings:** Cadila has lined up a strong product pipeline for future, which would enable it to sustain the growth momentum going ahead. The company has planned for filling of 30+ ANDAs in FY2021 and 40 to 45 ANDA's in FY2022. In 1HFY2021, the company has filed for 10 ANDAs.
- **Biosimilars:** Cadila is working around a few products (in the development stage now) in the Biosimilars space. Initially, the company plans to tap the less-regulated markets of Russia, Latin America, and Columbia and then gradually looks to enter the developed markets of US and EU.
- **COVID-19 vaccine:** Cadila is developing a vaccine for treatment of COVID-19. Currently, the vaccine is under trial stage. The company expects the final data from the vaccine trials to come in by March–April 2021. In addition to this, the company is exploring options for a collaboration with MNC companies for a possible tie up for vaccine manufacturing and distribution. However, the outcome of the trials is a key monitorable.
- **R&D:** The company has guided for R&D expense of 7-8% for FY2021.
- **Debt repayment:** Cadila has managed to substantially reduced its debt as of September 2020. Net debt has reduced by around 2709 crore in 1HFY2021. This is almost 40% lower than the net debt in March 2020.

Results Rs cr

Particulars	Q2FY2021	Q2FY2020	YoY %	Q1FY2021	QoQ%
Total Operating Revenue	3,820.0	3,366.6	13.5	3,639.9	4.9
Expenditure	2,956.6	2,741.0	7.9	2,824.5	4.7
Operating profit	**863.4**	**625.6**	**38.0**	**815.4**	**5.9**
Other Income	27.5	26.9	2.2	22.5	22.2
EBITDA	**890.9**	**652.5**	**36.5**	**837.9**	**6.3**
Interest	45.7	89.7	-49.1	67.7	-32.5
Depreciation	179.0	172.3	3.9	176.8	1.2
PBT	**666.2**	**390.5**	**70.6**	**593.4**	**12.3**
Taxes	110.6	39.5	180.0	123.5	-10.4
PAT	555.6	351.0	58.3	469.9	18.2
Minority Interest	49.8	24.3	104.9	-15.9	-760.0
Adjusted PAT	**605.4**	**375.3**	**61.3**	**454.0**	**33.3**
Reported PAT	473.4	107.2	341.6	454.0	4.3
Margins			**BPS**		**BPS**
OPM %	22.6	18.6	402.0	22.4	20.0

Source: Company; Sharekhan Research

Revenue Mix Rs cr

Particulars	Q2FY2021	Q2FY2020	YoY %	Q1FY2021	QoQ%
India	**1583.3**	**1429.8**	**10.7%**	**1486.0**	**6.5%**
Human formulations	1087.0	977.8	11.2%	829.2	31.1%
Consumer Wellness	335.2	317.2	5.7%	531.6	-36.9%
Animal Health & Others	161.1	134.8	19.5%	125.2	28.7%
US Formulation	1709.0	1448.4	18.0%	1623.2	5.3%
EM & LATAM Formulations	236.1	218.9	7.9%	237.5	-0.6%
Europe Formulations	54.6	40.7	34.2%	48.9	11.7%
APIs	159.7	104.9	52.2%	130.9	22.0%
Alliances	19.6	1.5	1206.7%	22.8	-14.0%
Grand Total	**3762.3**	**3244.2**	**16.0%**	**3549.3**	**6.0%**
OOI	57.7	122.4	-52.9%	90.6	-36.3%
Total Operating revenues	**3820.0**	**3366.6**	**13.5%**	**3639.9**	**4.9%**

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector View:** Growth momentum to improve: Indian pharmaceutical companies are better placed to harness opportunities and clock 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 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 the key growth drivers. This would be complemented by the strong capabilities developed by Indian companies (leading to a shift towards complex molecules, biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharma companies.

■ **Company Outlook: Healthy growth outlook:** Cadila is getting in a sweet spot wherein both its geographies have an improved growth outlook. The US, which accounts for close to almost half its revenue, is on a strong footing. Helped by easing pricing pressures, sturdy new product pipeline, and ramp-up in the recent product launches would be key growth drivers. The efforts to built 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 the growth momentum. Solid presence in the chronic and sub-chronic segments (which are key growth drivers for the Indian pharmaceutical markets) and an improving outlook for the acute segment provide ample growth visibility. Further, COVID-19 related opportunities would add to the growth momentum. With substantial reduction in debt in 1HFY2021, 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 - Retain Buy with a revised PT of Rs. 530:** Cadila reported a strong performance for Q2FY2021. The company's both key segments, the US and India, have staged double-digit growth and are expected to witness improved growth traction. Stabilising price erosion in US markets, a sturdy product pipeline with a focus on specialty and complex generics products would be key positives. While in India, new launches, COVID-19 related opportunities, and strategic restructuring of the business, would fuel growth. The recent new launches such as pressurised Metered Dose Inhaler – Forglyn in India are also expected to add to growth. Cadila is also developing a vaccine for COVID-19 and expects the results from trials by March – April 2021. If approved, this could unlock a sizeable growth opportunity. Further, Cadila has been able to substantially reduce its debt in 1HFY2021. This coupled with strong margin expansion has resulted in an upward revision in FY2022/FY2023 earnings estimates by 6% and 4%, respectively. At the CMP, the stock trades at 21.3x/18.1x its FY2022/FY2023 estimates. Strong growth prospects and earnings visibility, a sturdy balance sheet, and healthy return ratios would support multiple re-rating. We retain our Buy recommendation on the stock with a revised PT of Rs. 530.

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
AurobindoPharma	770.0	58.6	45,099.0	15.5	13.7	12.6	9.8	8.4	7.0	19.0	17.9	16.6
Cadila Healthcare	437.0	102.4	44,783.6	29.6	24.0	21.2	19.0	14.8	12.9	14.6	15.9	15.9

Source: Company, Sharekhan estimates

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.. Helped by 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 built 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 the 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	3.45
2	Kotak Mahindra Asset Management Co	2.14
3	GOVERNMENT PENSION FUND - GLOBAL	1.12
4	Norges Bank	1.12
5	Aditya Birla Sun Life Trustee Co	1.11
6	ICICI Prudential Asset Management	0.95
7	Vangaurd Group	0.81
8	UTI Asset Management Co	0.77
9	Franklin resources	0.71
10	Reliance Capital Trustee Co	0.49

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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