Sharekhan by BNP PARIBAS

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Cipla Limited

Strong quarter; Healthy growth outlook

Pharmaceuticals	Sharekhan code: CIPLA	Result Update

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		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 826**	
Price Target: **Rs. 950**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

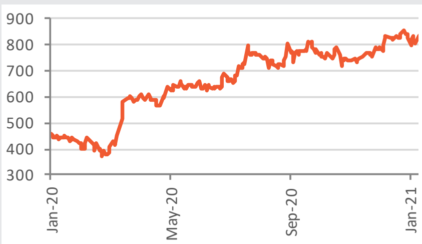
Company details

Market cap:	Rs. 66,581 cr
52-week high/low:	Rs. 870 / 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	-0.2	8.4	21.2	79.0
Relative to Sensex	2.5	-8.1	-0.4	66.6

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy recommendation on the stock of Cipla with an unchanged PT of Rs. 950.
- Q3FY2021 was a strong quarter with margins expanding sturdily on account of cost optimisation efforts. Results are ahead of estimates
- Cipla's One-India strategy has played out well and has yielded synergies across its business. Increased prescription generation backed by sustained traction in chronic and a likely revival in the acute therapy would drive growth of the India business.
- Healthy growth prospects across geographies, strong earnings visibility, and a healthy balance sheet augur well and will be key positives for Cipla.

Cipla Limited (Cipla) reported strong results for Q3FY2021 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. 5,169 crore grew by 18.2% y-o-y, backed by sturdy 21.6% y-o-y growth in India business. The surge in chronic therapies, COVID-19 led opportunities resulted in strong growth for India business. Operating profit margin (OPM) expanded by 650 bps y-o-y to 23.8%, led by cost-optimisation measures. Operating profit increased by 62.4% y-o-y to Rs. 1,231 crore. Tracking the operating performance, PAT at Rs. 748 crore grew by 113% 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 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 for Cipla. This, coupled with likely recovery in the acute therapy and improvement in the hospital business would drive the India business. Ramp up in the gAlbuterol sales with the Cipla gaining a 12% share of the total Albuterol market in US, strong new product pipeline including complex generics and respiratory products would drive the US sales. The South Africa business is also expected to sustain the strong double-digit growth momentum. We expect Cipla's topline and PAT to report a CAGR of 12% and 32%, respectively, over FY2020-FY2023E. Moreover, the management is working closely with USFDA to resolve issues at its Goa plant. Also the board has approved a scheme of arrangement where in the India based US business and consumer healthcare business would be transferred to two different wholly owned subsidiaries with a view to reap benefits of synergies. The company sees this as a long term trigger and is subject to approvals.

Key positives

- India revenue grew by 21.6% y-o-y backed by healthy growth in chronics and Covid-related opportunities, outperforming the market growth.
- Emerging markets revenues grew by 51% y-o-y driven by a strong demand across regions.
- Cost-optimisation measures resulted in OPM expansion of 650 bps y-o-y to 23.8%.

Key negatives

- Delay in resolution of USFDA observation at Goa plant.

Our Call

Valuation - Maintain Buy with a unchanged 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. Ramp up in the gAlbuterol, a strong product pipeline including complex generics and the growth in the base business could drive the US sales. Other geographies like South Africa are also on a strong footing to report healthy growth. Q3FY2021 was a strong quarter with margins expanding sturdily on account of cost optimisation efforts. Based on this, we have marginally revised our estimates upwards for FY2022/FY2023. We expect Cipla's revenue and PAT to report at an 12% and 32% CAGR, respectively, over FY2020-FY2023. Currently, the stock is trading at a valuation of 22.9x/19.1x 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 an unchanged 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.

Valuation (Consolidated) Rs cr

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Net sales	16362.4	17132.0	19307.1	21513.8	24120.2
Operating Profits	3573.9	3550.2	4716.0	5267.1	6061.8
OPM (%)	18.9	18.7	23.0	23.1	23.8
Reported PAT	1492.4	1499.5	2521.7	2914.5	3482.3
EPS (Rs)	18.7	19.2	31.3	36.1	43.2
PER (x)	44.1	43.0	26.4	22.9	19.1
EV/Ebidta (x)	22.9	21.6	15.4	13.5	11.3
P/BV (x)	4.4	4.2	3.7	3.2	2.8
ROCE (%)	11.1	11.6	17.4	18.2	19.6
RONW (%)	10.3	10.1	13.9	14.6	15.5

Source: Company; Sharekhan estimates

Strong performance; Cost-control measures drive margin expansion: Cipla reported strong performance for Q3FY2021, with results beating ours as well street estimates. Revenue grew by 18% y-o-y to Rs. 5,168 crore and is slightly ahead of estimates. Topline growth was led by a sturdy growth of 21.6% y-o-y growth in the Indian formulations business, while US revenue increased by 10% y-o-y. Among other geographies, emerging markets revenues grew by 51% y-o-y while that of the South Africa, Sub Saharan and the Global Access (SAGA) revenue grew by 10% y-o-y. During the quarter, Cipla outperformed the market growth in the Indian and South Africa markets. OPM for the quarter grew by 650 bps y-o-y to 23.8%. The margin expansion can be attributed to cost-control measures being implemented resulting in a 750 bps y-o-y drop in other expenses / sales. Operating profit for the quarter stood at Rs. 1231 crore, up 62.3% y-o-y. Tracking the operating performance, adjusted PAT stood at Rs. 748 crore, up 113% y-o-y and was comfortably ahead of estimates.

Domestic business traction to improve: The India business accounts for around 40% of the company's overall sales. Revenue from India business for the quarter stood at Rs. 2231 crore, up 21.6% y-o-y. Growth was primarily led by prescriptions business (up 25% y-o-y) because of sustained traction in the chronics portfolio, COVID led opportunities and recovery in hospitals and acute business as OPD consultations begin. Going ahead, Cipla expects traction in the India business to sustain and looks to outperform the IPM (Indian Pharmaceutical Markets) growth. Cipla's 'One-India strategy' has played out well with the benefits being reflected in improved OPM. Under the One-India strategy, the management has successfully merged three segments (Trade + Prescription+ OTC) in India business to leverage the existing product portfolio and distribution reach. Synergies in the logistics and distribution front, and efforts to consumerise strong brands especially in the consumer health space would be the key growth drivers for the India business growth. 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. Overall, the management is confident of sustaining strong growth trajectory and expects to continue outperforming the markets.

gAlbuterol ramp up, strong new product pipeline to aid the growth in the US business: Cipla's US business constitutes around 38% of Q3FY2021 revenues and staged a growth of 10% y-o-y for the quarter. The growth is led by continued expansion in market share of gAlbuterol and other existing assets, coupled with a growth in the institutional segment. Cipla's has been able to garner a 12% market share of the Abuterol market in the Us in a relatively shorter time. Going ahead the management expects a further ramp up to be gradual one but seems confident of gaining market share. In addition to the ramp up in the Albuterol, a strong new product pipeline consisting of complex generics and injectables is likely to unfold commencing Q1FY2022, would strengthen the company's presence in the US markets and lead to a growth in the US sales.

Q3FY2021 Conference call highlights

- **Regulatory updates:** Cipla's Goa plant is classified as an OAI by the USFDA. The company is working with the regulator to comprehensively address the observations in Goa plant.
- **South African business:** The South African business, which includes South Africa, sub-Saharan, and global access grew by 10% y-o-y in INR terms while in local currency terms the performance was in line. The company continues to outperformed the market growth substantially. Cipla has a market share of 7.2% in South African OTC markets. Cipla has also partnered with Alvotech for 4 products in the oncology space.
- **North America:** Revenue grew by 9.6% y-o-y to Rs. 1,037 crore for the quarter, however the growth was 6% y-o-y in USD terms. Continued expansion in market share for Albuterol and traction in other assets along aided the growth. In the 9M FY21 the respiratory franchise in the US crossed $100 mn sales, which is a significant milestone achieved.
- **Emerging markets:** The emerging market business reported an impressive growth of 51% y-o-y, driven by continued demand across regions and the segment with the highest growth in quarter. Also the company has gained market share in the Europe in DTM segment during the quarter.
- **R&D:** R&D spends stood at Rs. 221 crore, at 4.3% 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.
- **Debt:** Cipla's debt as of December 2020 stands at Rs 1807 crore as against Rs 3169 crore as of September 2020, translating in to a repayment of 1362 crores.

Results

Rs cr

Particulars	Q3FY2021	Q3FY2020	YoY %	Q2FY2021	QoQ %
Revenues	5168.7	4371.0	18.2	5038.3	2.6
Expenditure	3937.8	3612.7	9.0	3861.7	2.0
Operating profit	1230.9	758.3	62.3	1176.6	4.6
Other income	86.9	72.1	20.5	53.5	62.6
EBIDTA	1317.8	830.5	58.7	1230.0	7.1
Interest	47.9	46.2	3.7	39.3	21.8
Depreciation	248.4	277.9	-10.6	265.1	-6.3
PBT	1021.5	506.4	101.7	925.7	10.4
Tax	269.0	152.8	76.0	263.8	2.0
Adjusted PAT	748.2	351.0	113.2	665.4	12.4
			bps		**bps**
OPM (%)	23.8	17.3	647	23.4	46

Source: Company; Sharekhan Research

Geographical Sales Break-Up – Quarterly

Rs cr

Geograpghy Mix (Rs Cr)	Q3FY2021	Q3FY2020	YoY %	Q2FY2021	QoQ %
India (Rx+Gx)	2231	1834	21.6	2090	6.7
North America	1037	946	9.6	1049	-1.1
SAGA	913	831	9.9	924	-1.2
EM	488	323	51.1	474	3.0
Europe	252	190	32.6	247	2.0
API	201	165	21.8	189	6.3
Others	46	82	-43.9	66	-30.3
Total	**5168.0**	**4371.0**	**18.2**	**5039.0**	**2.6**

Source: Company; Sharekhan Research

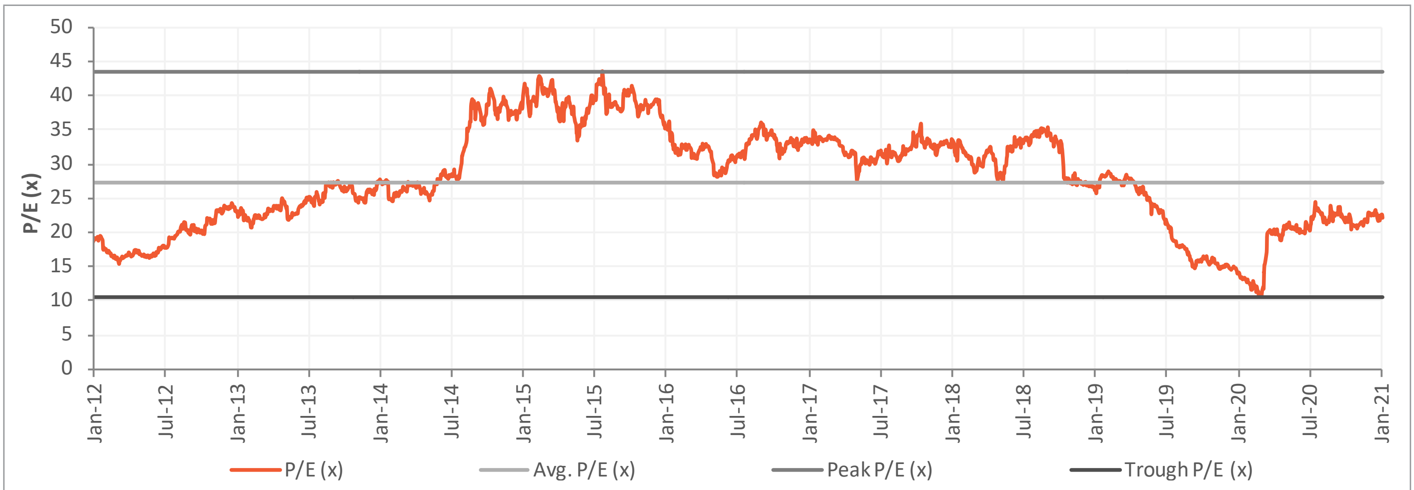
Outlook and Valuation

- **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, followed by the US business which is also expected to gain traction. 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 a likely improvement in the acute therapy segment would fuel growth for India business. 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 comprising complex generics, 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. Also the board of directors have approved a scheme of arrangement where in India based US business and the consumer healthcare business would be transferred to two different wholly owned subsidiaries with a view to reap benefits of synergies, which seems to be a long term trigger if approved by the NCLT.

- **Valuation - Maintain Buy with a unchanged 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. Ramp up in the gAlbuterol, a strong product pipeline including complex generics and the growth in the base business could drive the US sales. Among other geographies, South Africa is also on a strong footing to report healthy growth. Q2FY2021 was a strong quarter with margins expanding sturdily on account of cost optimisation efforts. Based on this, we have marginally revised upwards our estimates for FY2022/FY2023. We expect Cipla's revenue and PAT to report at an 12% and 32% CAGR, respectively, over FY2020-FY2023. Currently, the stock is trading at a valuation of 22.9x/19.1x 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 an unchanged 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	826.0	80.6	66581.0	43.0	26.4	22.9	21.6	15.4	13.5	10.1	13.9	14.6
Lupin	1008	45.3	49,063	129.5	42.2	24.8	21.7	16.5	11.3	2.8	8.0	11.9
Aurobindo	998	58.6	58476	18.2	16.9	14.7	11.4	10.2	8.4	19.0	17.2	16.8

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 banks on its branded business in India and South Africa, both of which together contribute ~60% of business. A solid presence in the chronics segment in the domestic markets along with market leadership position in select chronic therapies such as – respiratory, inhalation, and Urology bodes well for the company. Moreover, likely improvement in the acute therapy segment would fuel growth for India business. 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 comprising complex generics, 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 could lead to margin expansion. Board of directors have approved a scheme of arrangement where in India based US business and the consumer healthcare business would be transferred to two different wholly owned subsidiaries with a view to reap benefits of synergies, which seems to be a long term trigger if approved by the NCLT.

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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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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