Cipla Ltd

High base slows Q1 growth; prospects stay bright

Pharmaceuticals	Sharekhan code: CIPLA		
Reco/View: Buy ↔	CMP: Rs. 978	Price Target: Rs. 1,150 ↔	

↑ 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 31.32
Updated Feb 08, 2022

High Risk

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

Source: Morningstar

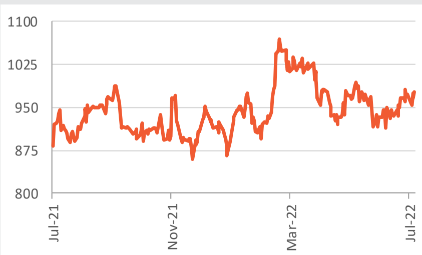
Company details

Market cap:	Rs. 78,935 cr
52-week high/low:	Rs. 1,083 / 850
NSE volume: (No of shares)	26.2 lakh
BSE code:	500087
NSE code:	CIPLA
Free float: (No of shares)	53.5 cr

Shareholding (%)

Promoters	33.6
FII	25.5
DII	21.4
Others	19.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.4	-0.4	3.5	10.9
Relative to Sensex	-5.1	-1.3	4.3	1.5

Sharekhan Research, Bloomberg

Summary

- Cipla reported weak results for Q1FY23 on a y-o-y basis given the high base due to Covid-led demand. however sequentially, there has been a marked improvement with the operating profit and PAT staging a double digit growth.
- The outlook for US business is strong backed by growth in the respiratory products and high-value launches being lined up in H2FY23 in the US markets.
- Cipla expects to outperform the Industry growth in the domestic markets, backed by strong growth in the acute as well as chronic therapies, new brands and likely traction in consumer business
- We maintain our Buy recommendation on Cipla Limited with an unchanged PT of Rs. 1,150. While there are near-term challenges in the form of likely cost pressures, long-term growth drivers are in place.

Cipla Q1FY23 performance was weak on a y-o-y basis given the high base due to Covid-led demand in Q1FY22. However sequentially, there has been a marked improvement with the operating profit and PAT staging a double-digit growth. The performance in the US markets has been impressive with a y-o-y double-digit growth, while the India business was impacted due to a higher base. Operationally the results are in line with the estimates. The outlook for the Indian as well as the US business is expected to be strong with high-value launches being lined up in H2FY23 in the US markets. Also, traction in acute and chronic therapies, focus on enhancing reach, and traction in the consumer business would drive up India sales. As cost pressures are likely to stay high, the management expects the FY23E OPMs to be at 21-22% (FY22 OPMs at 20.9%) despite topline traction.

Key positives

- US sales grew by 15.5% y-o-y due to healthy growth in the respiratory and peptide Assets.
- International market revenues grew by 23.6% y-o-y backed by a strong traction across geographies and steady growth in secondary terms.

Key negatives

- India revenues declined 8.4% y-o-y due to a high base on account of Covid-led demand in Q1FY22.
- Operating margins declined y 317 bps y-o-y due to ahigh base and elevated cost pressures

Management Commentary

- Cipla's India business is one of the key growth drivers backed by synergies from the One-India strategy, growth in existing products and launch of new brands and a robust outlook for the consumer segment.
- Sustained market share in the US markets in the respiratory franchise and pipeline of substantial high-value new product launches in the US planned in 2HFY2023, could be key growth drivers for the US business.
- The management expects a healthy traction on the topline front, however due to likely elevated cost pressures The management has guided for OPMs of 21%-22% for FY23 as compared to 21% in FY22.

Revision in estimates – Cipla's Q1FY23 performance was weak on a y-o-y basis given the high base due to Covid led demand, however sequentially, there has been a marked improvement. The performance in the US markets has been impressive with a y-o-y double digit growth, while the India business was impacted due to a higher base. Operationally the results are in line with the estimates and basis of this we have retained our FY23/FY24E estimates.

Our Call

Valuation – Maintain Buy with unchanged PT of Rs. 1,150: Growth prospects for the India business are strong and the Cipla is expected to outpace industry growth, while US business is also expected to stage an improvement backed by the growth in its existing portfolio and high-value product launches planned in H2FY23. The South African business also offers a healthy growth outlook. At CMP, the stock is trading at a P/E multiple of 25.4x/20x its FY23E/FY24E earnings, which is lower than the long-term historical average multiple. We maintain our Buy recommendation on the stock witan h unchanged PT of Rs. 1,150.

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	FY2021	FY2022	FY2023E	FY2024E
Net sales	19159.6	21763.3	23390.3	26228.8
Operating Profits	4517.9	4833.7	5370.8	6525.8
OPM (%)	22.2	20.9	21.7	23.8
Reported PAT	2388.0	2546.8	3085.2	3921.8
EPS (Rs)	29.8	34.0	38.5	48.9
PER (x)	32.9	28.8	25.4	20.0
EV/Ebidta (x)	18.8	17.1	15.4	12.4
P/BV (x)	4.3	3.8	3.3	2.9
ROCE (%)	16.6	17.2	17.6	19.6
RONW (%)	13.9	14.6	13.9	15.4

Source: Company; Sharekhan estimates

Operating profits in line with estimates

Cipla Q1FY23 performance was weak on a y-o-y basis given the high base due to Covid-led demand. However sequentially, there has been a marked improvement with the operating profit and PAT registering a double-digit growth. The performance in the US markets has been impressive with a y-o-y double-digit growth, while the India business was impacted due to a higher base. Operationally the results are in line with the estimates. The sales at Rs 5375 cr declined by 2.3% y-o-y, while sequentially was up 2.2%. The India revenues declined sharply by 8.4% y-o-y but grew by 13.7% q-o-q driven by a momentum across therapy areas. The US revenues grew strongly by 15.5% y-o-y. Operating margins contracted by 317 bps y-o-y to 21.3%, but were above the estimates of 20%. High margins base in the Q1FY22 and overall elevated costs resulted in OPM contraction. The gross margins contracted by 30 bps y-o-y to 61.9%. The EBITDA at Rs 1143 crore declined by 15% y-o-y and was in line wit the estimates of Rs 1128 cr. Tracking the operating performance the adjusted PAT at Rs 686.4 cr declined by 18.1% y-o-y and was slightly ahead of the estimated Rs 644 cr.

Ramp-up in the existing portfolio in US, focus on complex products to drive growth

Cipla's US sales for the quarter have reported a strong double-digit growth of 15.5% y-o-y despite competitive pressures and cost pressures. Robust momentum in core formulation business; strong traction in respiratory assets as well as a contribution from peptidassetset resulted in a strong double-digit growth for the US region. Cipla in the recent past received approval for Arformoterol Tartrate Inhalation Solution, and this strengthened the respiratory franchise further. gAlbuterol continued its growth trajectory in the quarter and commanded a market share of ~22% of the overall market. Given substantial headroom available for growth in gAlbuterol, management is eyeing incremental market share gains. Also Cipla has received approval from the USFDA for Lanreotide injection which was under the 505 (b)(2) pathway, a complex product to manufacture and offers sizeable growth opportunities. The company has launched the product in the US markets and now is working towards ramping up its sales. In addition to this, the company has a strong product pipeline of complex and high-value products to be launched in the US with a majority of them likely in H2FY2023. These include the likes of Advair, gRevlimid and peptides injectables the approval for this is expected in FY2023. In addition to Advair, the company has two more assets in the pipeline, which are expected to be commercialised in late FY2023 / early FY2024, coupled with the unlocking of the peptide portfolio thus pointing toward strong traction in high-value complex products that would strengthen the company's presence in US markets. The management believes that price pressures would sustain but the product launch momentum could enable it to tide over the same.

Cipla to outperform industry growth in the domestic business

In Q1FY23 Cipla's India business reflected the impact of a high base on account for a covid led demand which led to higher Sales in Q1FY22. With the Covid instances being substantially lower the benefit of Covid led product has waned away leading to normalization. India sales at Rs 2483 crore declined by 8.4% y-o-y, though sequentially it was up 13.7%. Adjusted for Covid-led products the growth stood at 9% y-o-y, which is higher than the Industry growth. Going ahead, Cipla expects traction in India business to outperform IPM's growth. Cipla's One-India Strategy has played out well and management now aims to grow further. This, coupled with the company's strong position in the chronic segments in which it is amongst the top ranked players could help it post strong growth. Chronic therapies account for 55% of the overall India sales. In the past, the growth in chronic therapies has helped Cipla outpace the industry growth in its prescriptions business. Cipla has string product portfolio across therapies and the sales from the same is expected to ramp up. The company is witnessing increased traction in the branded prescription business and has outpaced industry growth. Moreover, the recent price hike initiated by the National Pharmaceutical pricing Authority (NPPA) of 10.8% effective April 2022 could help companies such as Cipla to mitigate the cost pressures, though partly. The NLEM (National List of Essential Medicines) drugs account for ~23% of Cipla's domestic sales and a price hike by the NPPA bodes well with the full impact of the same likely in FY23E. Moreover, the company is witnessing healthy order flows in the trade generics business across regions, which would support growth. Cipla's consumer health business is witnessing strong traction and is expected to sustain the growth trajectory driven by the recently acquired Endura Mass also strengthening the consumer portfolio.

South African business

The South African business, which includes South Africa, the sub-Saharan region, and global access, de-grew by 6% y-o-y in rupee terms to Rs. 788 crore. In South Africa business muted sales in the primary sales impacted the performance of the region. The management expects the sales to improve starting Q2FY23. However the secondary term, terms, and strong demand continues with South Africa private business continuing to outperform market. Cipla in the overall South Africa Market has outperformed the industry growth posting a 10.6% growth against 7% growth in the industry.

Emerging markets and Europe (International Markets)

The international markets business grew by 23.6% y-o-y to Rs 720 crore. The company maintained its scale supported by growth across geographies with steady double-digit growth in the secondary market, while the growth in the B2B segment in the Europe markets remained muted.

R&D

R&D spends at Rs 274 crore were higher by 4% y-o-y due to ongoing clinical trial across the respiratory franchise with two assets going in the Clinical stage. Going ahead with the clinical trials underway the management expects the R&D spending to inch up.

Results (Consolidated) Rs cr

Particulars	Q1FY2023	Q1FY2022	Y-o-Y %	Q4FY2022	Q-o-Q %
Revenues	5375.2	5503.6	-2.3	5260.3	2.2
Operating profit	1143.4	1345.1	-15.0	949.7	20.4
Other income	103.4	64.9	59.3	64.0	61.6
EBIDTA	1246.8	1410.0	-11.6	1013.7	23.0
Interest	17.8	29.6	-39.8	18.1	-1.6
Depreciation	254.4	261.1	-2.6	290.3	-12.4
PBT	974.6	1119.3	-12.9	705.3	38.2
Tax	268.0	283.7	-5.5	71.1	276.9
Adjusted PAT	686.4	838.5	-18.1	619.6	10.8
Margins			**Bps**		**bps**
OPM (%)	21.3	24.4	-317	18.1	322
Adj. profit margin (%)	12.8	15.2	-247	11.8	99
Tax Rates (%)	27.5	25.3	215	10.1	1742

Source: Company; Sharekhan Research

Geographical Sales Break-Up – Quarterly

Geograpghy Mix (Rs Cr)	Q1FY2023	Q1FY2022	Y-o-Y %	Q4FY2022	Q-o-Q %
India (Rx+Gx)	2483	2710	-8.4	2183	13.7
North America	1199	1038	15.5	1209	-0.8
SAGA	788	837	-5.9	953	-17.3
International Markets	720	582	23.7	732	-1.6
API	135	302	-55.3	137	-1.5
Others	51	36	41.7	46	10.9
Total	**5376.0**	**5505.0**	**-2.3**	**5260.0**	**2.2**

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, plant resolutions by the USFDA, 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 to a strong growth potential going ahead for pharmaceutical 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 chronic segment along with market leadership position in select chronic therapies such as respiratory and inhalation bodes well for the company. Moreover, likely traction in the acute therapies segment could also 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. The recent price hike announced by NPPA to the tune of 10.8% is likely to benefit Cipla as it has 23% of India's sales from the products under the NLEM. Backed by a strong product launch pipeline comprising complex generics and high market potential launches, the US business is expected to report healthy growth, with Albuterol, Aformeterol and Brovana ramp-up and likely new approvals being key growth drivers. 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 are expected to sustain going ahead as well, leading to an improvement in margin trajectory.

- **Valuation – Maintain Buy with an unchanged PT of Rs. 1,150:** Cipla expects India business to post strong growth going ahead, backed by growth in core therapies, synergies from One-India Strategy, and an expected pick-up in chronic as well as acute therapies, which could drive domestic topline and Cipla is likely to outpace the industry's growth. A ramp-up in gAlbuterol, and Arformoterol market shares, and a strong product pipeline including complex generics, could drive US sales higher. Backed by a slew ohigh-valueue launches, Cipla expects growth to pick up in US business in 2HFY2023E. However, the management sees the raw material cost as well as freight cost to be higher and expects FY23E OPMs to be in the 21% to 22% range despite of a likely topline traction. Cipla's Q1FY23 performance was weak on a y-o-y basis given the high base due to Covid-led demand, however sequentially, there has been a marked improvement. The performance in the US markets has been impressive with a y-o-y double-digit growth, while the India business was impacted due to higher base. Operationally the results are in line with the estimates and basis this we have retained our FY23/FY24E estimates. At the CMP, the stock is trading at P/E multiple of 25.4x/20x its FY23E/FY24E earnings, which is lower than the long-term historical average multiple. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 1,150.

One-year forward P/E (x) band

Source: Company, Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBITDA (x)			RoE (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Cipla	978.0	80.6	78935.0	28.8	25.4	20.0	17.1	15.4	12.4	14.6	13.9	15.4
Strides Pharma Science	331	9.0	2,976	-	19.8	12.0	-	8.2	6.7	-	6.1	9.2

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 antiretrovirals. Going forward, the company is planning to launch combination inhalers in larger markets such as the US and EU and is setting up its 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 the business. A solid presence in the chronics segment in domestic markets along with a 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 foIndiania business. The One-India Strategy implemented by Cipla has played out well and is expected to result in strong growth momentum, well supported by the COVID-19 portfolio. 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.

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
Ms. Samina Hamied	Executive Vice-Chairperson
Mr. Umang Vohra	Managing Director and Global Chief Executive Officer
Mr. Dinesh Jain	Interim Global Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Fund Management	4.33
2	Life Insurance Corporation of India	3.6
3	Government Pension Fund	2.59
4	Norges Bank	2.31
5	BlackRock Inc	2.09
6	Vangaurd Group Inc	2.06
7	ICICI prudential Asset Management Co	1.63
8	NPS Trust	1.44
9	HDFC Asset Management	1.33
10	UTI Asset Management Co Ltd	1.17

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst and SHAREKHAN further certifies that neither he or his relatives or Sharekhan associates has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either, SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Ms. Priya Sonavane; Tel: 022–61150000; email id: compliance@sharekhan.com;

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

Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai–400028, Maharashtra, INDIA, Tel: 022–67502000 / Fax: 022–24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.