



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

Updated Oct 08, 2022

31.4

High Risk

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

Source: Morningstar

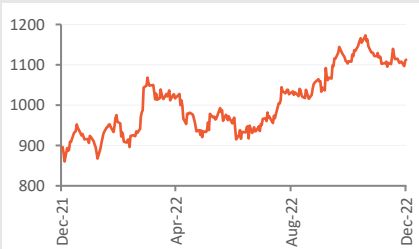
Company details

| | |
|-------------------------------|-----------------|
| Market cap: | Rs. 89,803 cr |
| 52-week high/low: | Rs. 1,185 / 850 |
| NSE volume: (No of shares) | 12.8 lakh |
| BSE code: | 500087 |
| NSE code: | CIPLA |
| Free float: (No of shares) | 53.7 cr |

Shareholding (%)

| | |
|-----------|------|
| Promoters | 33.4 |
| FII | 27.5 |
| DII | 21.6 |
| Others | 17.5 |

Price chart



Price performance

| (%) | 1m | 3m | 6m | 12m |
|--------------------|------|-----|------|------|
| Absolute | -1.5 | 7.7 | 21.6 | 35.1 |
| Relative to Sensex | -3.2 | 3.1 | -0.4 | 25.1 |

Sharekhan Research, Bloomberg

Cipla Ltd

Potential product launch delays raise risk of downgrade in earnings

| | | | | |
|------------------------|------------------------------|-----------------------|--------------------------------|---|
| Pharmaceuticals | Sharekhan code: CIPLA | | | |
| Reco/View: Hold | ↓ | CMP: Rs. 1,113 | Price Target: Rs. 1,210 | ↓ |
| | ↑ Upgrade | ↔ Maintain | ↓ Downgrade | |

Summary

- We reduce the Buy rating and price target (PT) on Cipla to HOLD, as we foresee headwinds to margins expansion and therefore reduce the earnings growth estimate to 17.1% CAGR vs. 20.5% CAGR estimated, before, during FY22-FY25E.
- Among the new set of complex product launches, gAbraxane is held up due to Goa site being under Official Action Indication (OAI) status and it can delay the launch by 6-9 months. Thereby, leading to potential downgrade in earnings estimates for FY2024.
- Cipla has witnessed a slower than expected growth in its India Pharma market sales in Q3FY23E (Oct and Nov 22) and has lagged behind the industry average growth rate.
- While on one side, recent product launches in the US are holding up in terms of market share and newly launched product is gaining market share, relatively earlier launched product, gAlbuterol is losing market share due to competition.

Cipla has seen an increase in the US's revenue base to USD 175 – 180 million a quarter vs. an average base of USD 155 million, before, driven by differentiated product launches, as of Q2FY23. Such differentiated product launches strengthen the company's sales prospects in the US, which it expects to drive with such complex products, especially, the respiratory and peptide products. The company has gAdvair launch lined up for H2FY23. However, with Official Action Indicated (OAI) at Goa site, gAbraxane's launch may get delayed by 6-9 months. The company believes once it becomes large enough in the US market, over the next 2-3 years, the growth rate is likely to slow down due to high base effect.

Product launch delays and expected slowdown in the US segment sales are concerns: The company has gAdvair launch lined up for H2FY23. However, with Official Action Indicated (OAI) at Goa site, gAbraxane's launch may get delayed by 6-9 months. The company believes once it becomes large enough in the US market, over the next 2-3 years, the segment growth rate is likely to slow down due to base effect. The company will see new spurt of growth from biosimilars launches, between 2028-2030 only.

Launch of novel variant of original branded Lupron Depot injection and new product launches are expected to support the new revenue base in the US segment: The company has launched Leuprolide depot injection in 22.5 mg strength in November 2022. It is a limited competition product with 2-3 brands in the market with 3 players. Cipla has seen an increase in the US's revenue base to USD 175 – 180 million a quarter vs. an average base of USD 155 million, before, driven by differentiated product launches as of Q2FY23. Recently, launched Lanreotide 505(b)(2) depot injection has been gaining steady market share. Such differentiated product launches strengthen the company's sales prospects in the US, which it expects to drive with such complex products, especially, the respiratory and peptide products.

Cipla underperforming Indian Pharma Market (IPM) growth will be a key monitorable: In Oct and November 22, Cipla grew below market growth. Since H2FY is a leaner period for Cipla's therapies, Cipla's India sales as reported by industry sources, will be a key monitorable, which can influence its domestic sales in H2FY23E.

Our Call

Valuation: It is facing one product launch delay in the US due to one of its facilities being OAI status. Also, Cipla is underperforming IPM growth so far in Q3FY23E (Oct and Nov 22), which will be a key monitorable going forward. Some of the recent product launches in the US are ramping up well but are being offset by base business' price erosion due to competition. The new product launches should help it to support and grow the new revenue base it has been able to achieve with high value complex product launches, recently. At the same time, the company has costs concerns due to geopolitical issues and increased R&D spend due to ongoing clinical trials on respiratory assets and other pipeline products. We therefore reduce the CAGR earnings growth estimate down to 17.1% from 20.5% estimated earlier, over FY22-FY25E. At the CMP, the stock trades at a relatively rich level of 27.5x/23.8x its FY2023E/FY2024E EPS. We now value the company's shares at 22.5x while applying it on FY25E EPS. As such, we reduce the PT to Rs. 1,210 (vs. earlier Rs. 1,300) and thereby reduce the rating to HOLD from BUY, as at the CMP, the stock indicates an upside potential of 8%.

Key Risks

- 1) Lower-than-expected growth in India market share and specialty segment revenue growth;
- 2) Currency risk; and
- 3) Delay in resolution of USFDA observations at its plant.

Valuation (Consolidated)

| Particulars | FY2021 | FY2022 | FY2023E | FY2024E | FY2025E |
|-------------------|----------|----------|----------|----------|----------|
| Net sales | 19,159.6 | 21,763.3 | 23,571.4 | 26,418.9 | 28,914.1 |
| EBITDA Margin (%) | 22.2% | 20.9% | 22.4% | 23.2% | 23.6% |
| Adj. PAT | 2,404.9 | 2,698.9 | 3,264.6 | 3,768.2 | 4,337.3 |
| Adj. EPS (Rs) | 29.8 | 33.5 | 40.5 | 46.7 | 53.8 |
| PER (x) | 37.3 | 33.2 | 27.5 | 23.8 | 20.7 |
| EV/EBITDA (x) | 20.9 | 19.5 | 16.8 | 14.5 | 13.0 |
| ROCE (%) | 15.8 | 16.0 | 16.9 | 17.2 | 17.4 |
| RONW (%) | 12.9 | 12.8 | 13.7 | 13.9 | 14.1 |

Source: Company; Sharekhan estimates

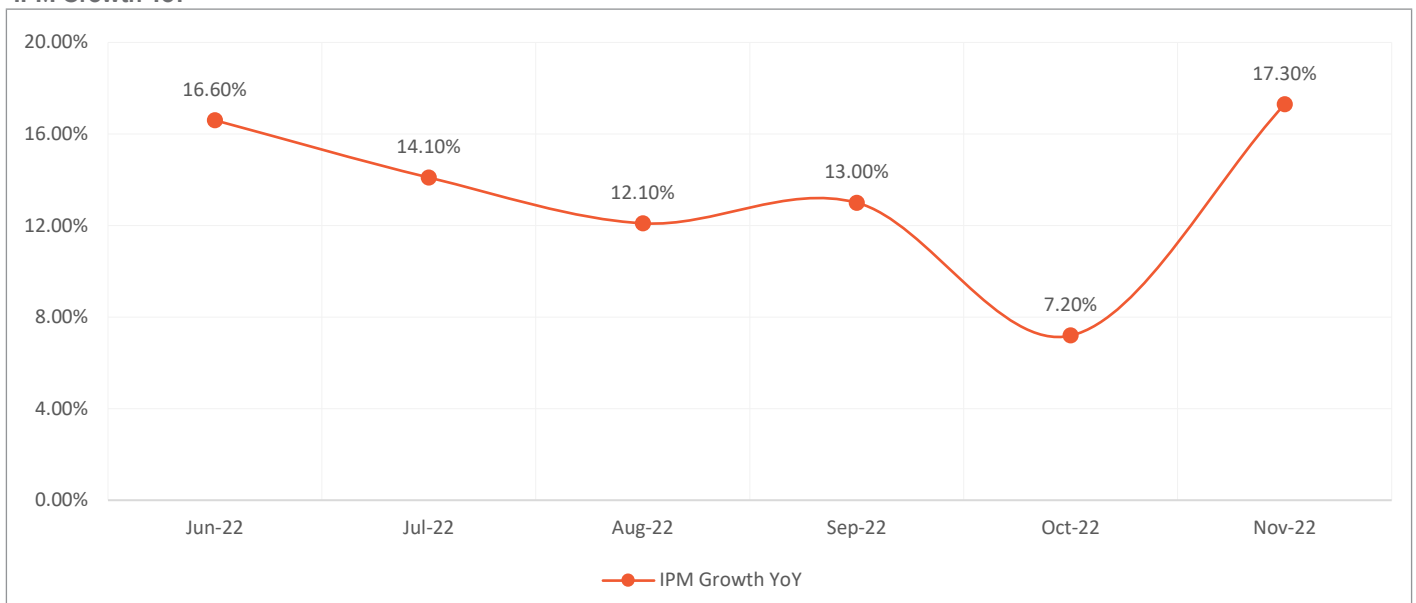
Product launch delays and expected slowdown in the US segment sales are concerns: The company has gAdvair launch lined up for H2FY23, which is expected to be a limited competition product over the next 2 years, with potential market size of USD 700 million. However, with Official Action Indicated (OAI) at Goa site, gAbraxane’s launch may get delayed by 6-9 months. The new respiratory inhaler product, currently under clinical trial, is likely to be filed by H1FY25. The company believes once it becomes large enough in the US market, over the next 2-3 years, the segment growth rate is likely to slow down due to base effect. The company will see new spurt of growth from biosimilars launches, between 2028-2030 only.

Launch of novel variant of original branded Lupron Depot injection and new product launches are expected to support the new revenue base in the US: The company has launched Leuprolide depot injection in 22.5 mg strength (which is a novel copy of original branded LUPRON DEPOT, 22.5 mg strength of AbbVie) in November 2022 with a potential market size of USD 200 million. It is a limited competition product with 2-3 brands in the market with 3 players.

Cipla’s has seen an increase in the US’s revenue base to USD 175-180 million a quarter vs. an average base of USD 155 million, before, driven by differentiated product launches as of Q2FY23. Recently, launched Lanreotide 505(b)(2) depot injection has been gaining steady market share. Its market share was at 9.6% as of Q2FY23 vs. 4.6% in Q1FY23 and is on track to reach to 15.0% levels by the end of the FY23E. Such differentiated product launches strengthen the company’s sales prospects in the US, which it expects to drive with such complex products, especially, the respiratory and peptide products.

Cipla underperforming industry growth will be the key monitorable: Indian Pharma Market (IPM) has rebounded at a strong pace of 17.3% YoY in Nov 2022 vs. 7.2% YoY growth visible in Oct 2022 (vs 6.6% YoY growth in Nov 2021 and 7.2% YoY growth seen in October 2021). In Oct and Nov 22, Cipla, however, grew below IPM growth. The therapies from which the company generates the largest revenue, such as Respiratory (33% of revenue) grew at above industry average growth of 20.9% YoY and anti-infectives (15%) grew below industry average growth of 14.8% YoY in November 2022. Since H2FY is a leaner period for Cipla’s therapies, Cipla’s India sales as reported by industry sources, will be the key monitorable, which can influence its domestic sales in H2FY23E.

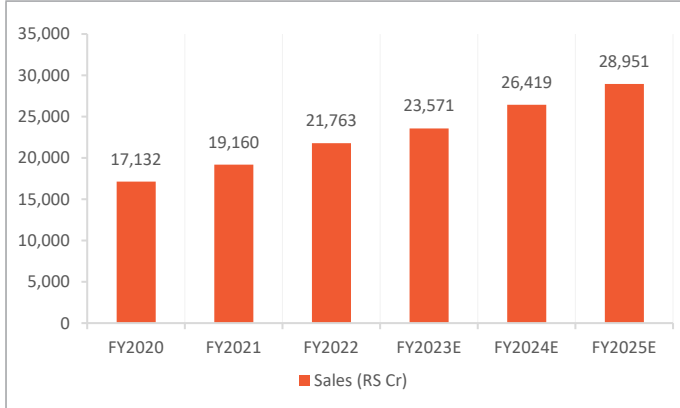
IPM Growth YoY



Source: India Ratings, AIOCD

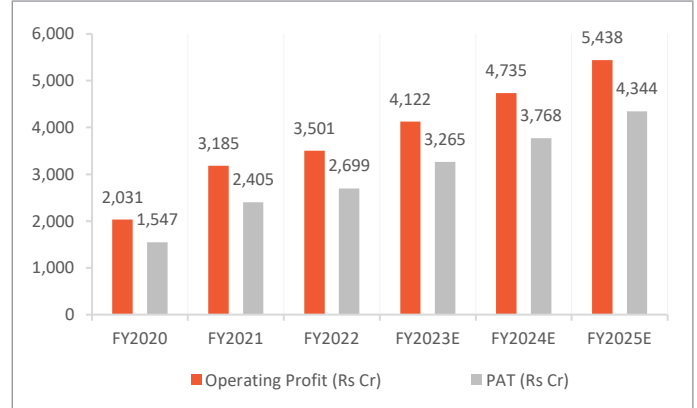
Financials in charts

Sales Trends



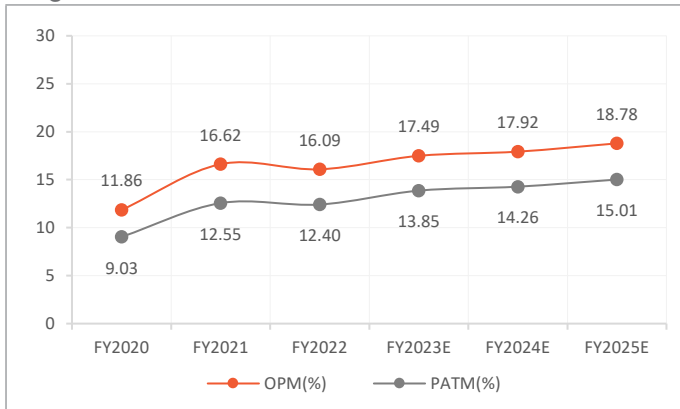
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



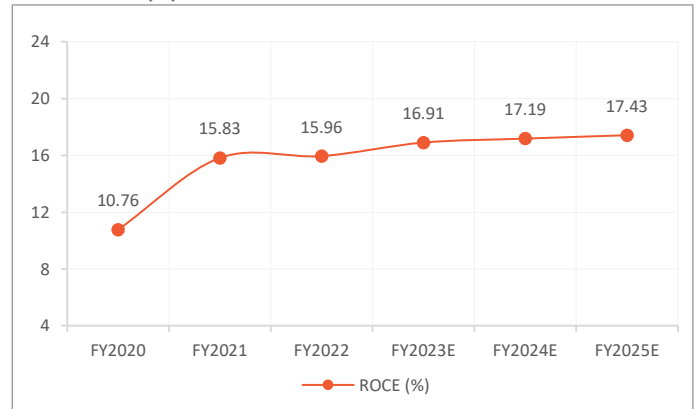
Source: Company, Sharekhan Research

Margin Trends



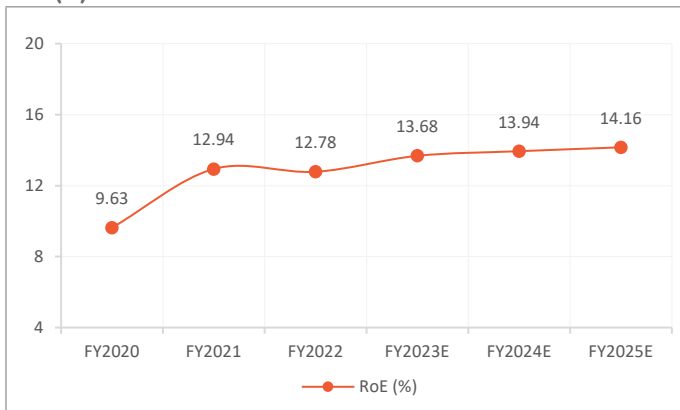
Source: Company, Sharekhan Research

RoCE Trend (%)



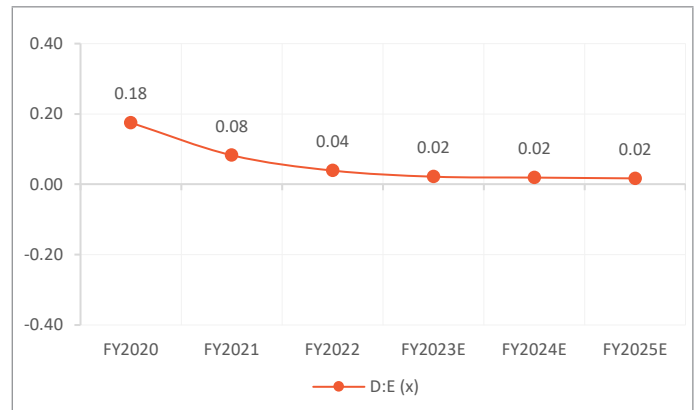
Source: Company, Sharekhan Research

RoE (%) Trends



Source: Company, Sharekhan Research

D:E



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Multiple growth engines ahead

The Indian Pharma market (IPM) is growing with increased consumer spend and awareness. Additionally, Indian pharmaceutical players with large market share in IPM and a strong pipeline of speciality products will help them gain market share in the US and thereby partially offset any impact of competitive pricing pressure in the US. Moreover, other factors such as faster product approvals and resolutions by the USFDA regards to plant observations and 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, biosimilars and injectables) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for Indian pharma companies.

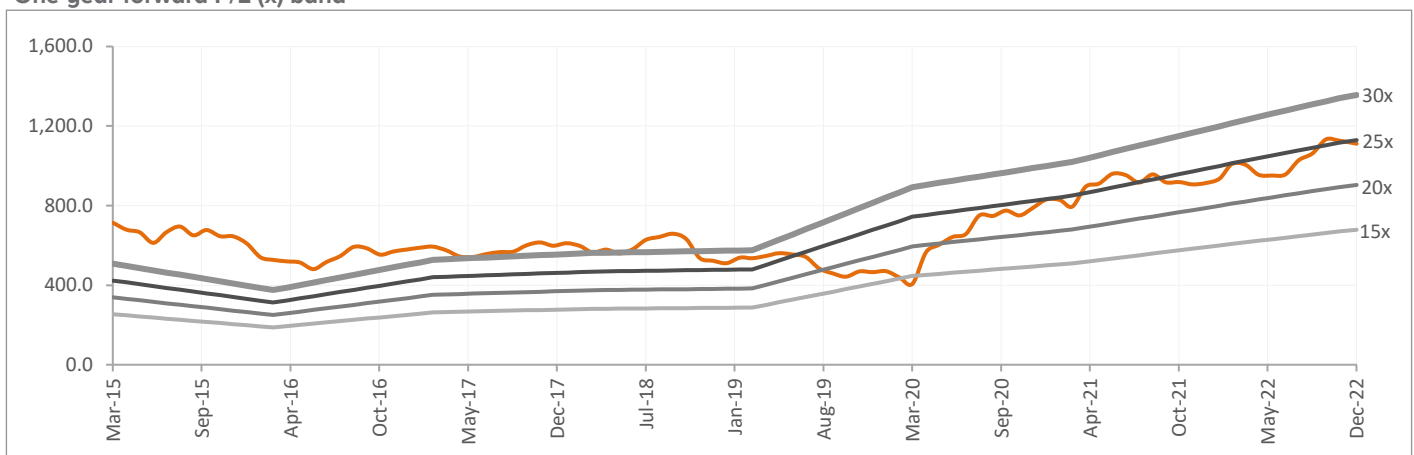
■ Company Outlook – Product launch delays in the US, a concern

Cipla's has seen an increase in the US's revenue base to USD 175 – 180 million a quarter vs. an average base of USD 155 million, before, driven by differentiated product launches. While Albuterol's market share is declining due to competition, gBrovana's market share is flattening. Albuterol's Gx share was 18.2% as of Q2FY22 vs. 16.0% in Q2FY23 while gBrovana's Gx share was 39.0% in Q2FY22 vs. 38.0% in Q2FY23. However, Lanreotide depot injection is gaining market share. Launch of Leuprolide depot injection in November 22 and gAdvair's in H2FY23 are expected to support the new revenue base to continue to grow; partially offset by erosion in the base business. However, some of the concerns are that gAbraxane's launch is likely to be delayed due to Official Action Indicated (OAI) at its Goa plant, currently. At the same time, India market growth is likely to slow down for Cipla due to it being seasonally weaker H2 of a FY for it. Delayed product launches in the US market and slower India market growth can impact the margin expansion than envisaged before. The company believes once it becomes large enough in the US market, over the next 2-3 years, the growth rate is likely to slow down due to base effect. The company will see new spurt of growth for the US market from biosimilars launches, between 2028-2030 only.

■ Valuation – Reduce to HOLD with a changed PT of Rs. 1,210

The company is facing one product launch delay in the US due to one of its facilities being OAI status. Also, Cipla is underperforming IPM growth so far in Q3FY23E (Oct and Nov 22), which will be a key monitorable going forward. Some of the recent product launches in the US are ramping up well but are being offset by base business' price erosion due to competition. The new product launches should help it to support and grow the new revenue base it has been able to achieve in the US segment, with high value complex product launches, recently. At the same time, the company has costs concerns due to geopolitical issues and increased R&D spend due to ongoing clinical trials on respiratory assets and other pipeline products. We therefore reduce the CAGR earnings growth estimate down to 17.1% from 20.5% estimated earlier, over FY22-FY25E. At the CMP, the stock trades at a relatively rich level of 27.5x/23.8x its FY2023E/FY2024E EPS. We now value the company's shares at 22.5x while applying it on FY25E EPS. As such, we reduce the PT to Rs. 1,210 (vs. earlier Rs. 1,300) and thereby reduce the rating to HOLD from BUY as at the CMP, the stock indicates an upside potential of 8%.

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 (%) | | |
|------------------------|------------------|-----------------|--------------|---------|-------|-------|---------------|-------|-------|---------|-------|-------|
| | | | | FY22 | FY23E | FY24E | FY22 | FY23E | FY24E | FY22 | FY23E | FY24E |
| Cipla | 1146.0 | 80.7 | 92,482 | 33.7 | 29.2 | 23.3 | 20.1 | 17.8 | 14.4 | 14.6 | 14.2 | 15.5 |
| Strides Pharma Science | 329.0 | 9.0 | 2,970 | - | 19.7 | 11.9 | - | 8.2 | 6.6 | - | 6.1 | 9.2 |
| Torrent Pharma | 1668.6 | 33.8 | 56,473 | 45.0 | 40.4 | 33.4 | 24.8 | 21.7 | 18.0 | 21.1 | 21.8 | 22.9 |

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 chronic 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 for the Indian 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. Ashish Adukia | Chief Financial Officer |
| Mr. Rajendra Chopra | Company Secretary |

Source: Company Website

Top 10 shareholders

| Sr. No. | Holder Name | Holding (%) |
|---------|---------------------------|-------------|
| 1 | SBI Funds Management | 4.61 |
| 2 | Life Insurance Corp India | 3.19 |
| 3 | Govt Pension Fund | 2.48 |
| 4 | BlackRock Inc | 2.54 |
| 5 | Norges Bank | 2.31 |
| 6 | Vanguard Group Inc | 2.12 |
| 7 | HDFC AMC | 1.64 |
| 8 | NPS Trust | 1.55 |
| 9 | UTI AMC | 1.09 |
| 10 | Schroders PLC | 1.02 |

Source: Bloomberg

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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 deteriorating 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: Ms. Binkle Oza; Tel: 022-61150000; email id: complianceofficer@sharekhan.com;

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

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