Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Cipla Ltd

In-line performance, earnings prospects weaken

Pharmaceuticals	Sharekhan code: CIPLA
Reco/View: Hold ↔	CMP: **Rs. 1,035** / Price Target: **Rs. 1,158** ↓

↑ 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	Positive	↔	Positive
RQ	Positive	↓	Neutral
RV	Positive	↓	Neutral

ESG Disclosure Score NEW

ESG RISK RATING 28.39

Updated Oct 08, 2022

High Risk

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

Source: Morningstar

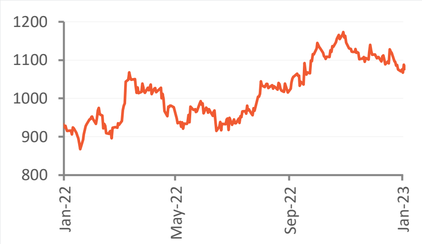
Company details

Market cap:	Rs. 83,559 cr
52-week high/low:	Rs. 1,185 / 867
NSE volume: (No of shares)	22.3 lakh
BSE code:	500087
NSE code:	CIPLA
Free float: (No of shares)	53.7 cr

Shareholding (%)

Promoters	33.4
FII	28.2
DII	21.0
Others	17.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.5	-10.4	5.9	11.6
Relative to Sensex	-8.4	-14.9	-3.0	2.2

Sharekhan Research, Bloomberg

Summary

- Cipla's Q3FY2023 numbers were in line with our expectations on revenue and EBITDA fronts but fared below expectations on a net income basis. It was largely due to higher interest and taxes.
- Outlook for the US business is strong with a quarterly run-rate of $195 million reached in Q3FY23 versus $175-180 million quarterly run rate reached, earlier, in Q2FY23, while the India consumer business is expected to deliver higher annual revenue of Rs. 1,100 crore by the end of FY2023 versus expectations of Rs. 600 crore of revenues guided for, before.
- R&D spend is likely to rise along with partnered products, which cannot support consistently higher margins, going forward, as Q3FY2023 margins were higher due to favorable products mix and strong seasonal buying in the US.
- We maintain our Hold rating on Cipla, with a revised price target of Rs. 1,158 as we believe that certain high value product launches such as gAbraxane and gAdvair being deferred due to pending USFDA facility clearances, expected increase in share of partnered products, and increased R&D spend, may not support consistent margins growth, going forward.

Q3FY2023 performance was in line on revenue and EBITDA fronts but underperformed on net income basis due to higher interest costs and taxes. The revenue grew at 6.0% y-o-y (-0.3% QoQ) to Rs. 5,810.1 crore, due to slower growth in India and International markets and decline in SAGA and API revenue; partially offset by strong growth in North America revenue. North America's revenue outlook has improved with its key respiratory products such as Albuterol and Arformoterol gaining market share y-o-y, while its recently launched peptide products such as Lanreotide and Leuprolide injections are gaining traction. The company expects these differentiated products coupled with expected launches of new complex products from FY2024 should help it sustain the US sales momentum over the next one year and beyond. India sales is slower, which is expected to pick up pace with strong product launches, increase in trade generics volumes and sales of consumer business. However, its increasing R&D and promotional investments, increasing partnered products' share likely, and macro headwinds and inflationary conditions may not support consistently higher margins, going forward.

Key positives

- US sales grew at a strong pace of 42.3% y-o-y in Q3FY23 due to recently launched complex and peptide products' gaining market share.
- Strong margin expansion due to growth in its branded markets and increased contribution from its differentiated products portfolio in North America and mix change; partially offset by increased R&D spend, macroeconomic headwinds and SAGA underperforming.

Key negatives

- Slower growth in India market over the past two quarters due to COVID 19 related high base effect
- Likely increase in R&D spends and marketing and promotions and partnered products' likely be weighing on margins.

Management Commentary

- It was the highest-ever quarterly revenue reported in North America segment as a result of strong traction in differentiated products, and market share gain in key respiratory and peptide injectable products. Lenalidomide's revenue was marginally lower QoQ in Q3FY2023. Peptide products' sales are tracking well.
- Trailing 12-month ROIC stood at 19.7%, which is at the higher end of the 17-20% target it has.
- R&D spend stood at Rs. 363 crore, or 6.2% of revenue in Q3FY2023. The R&D spend has been 1.75%, incrementally of the revenue and profits, due to continued investments in respiratory, biosimilars, and other projects. To increase gradually in the coming quarters.
- Consumer business including India and South Africa contributes 8.5% of the total revenue as of Q3FY2023, and the India consumer business is expected to reach to Rs. 1,100 crore of revenues by the end of FY2023.

Revision in estimates – We have broadly maintained our sales estimates for FY2024 and FY2025 but reduced its earnings estimates as Cipla's Q3 performance on margins front is unlikely to sustain going forward.

Our Call

View - Maintain Hold with revised PT of Rs. 1,158: The company witnessed strong growth in the North America markets, driven by higher share of complex and differentiated products such as Albuterol and Arformoterol and peptide injectables such as Lanreotide injection and Leuprolide depot injection, gaining market share. While some of the key products such as Abraxane and Advair are pending USFDA clearances for their launches, the company expects the recently launched products can sustain the sales momentum in the US over short to medium term. India and SAGA business posting strong growths will be key trigger for any re-rating for Cipla, going forward. We reduce our earnings estimates as the margins momentum is unlikely to sustain due to increased R&D, marketing and promotional investments, and partnered products, in the short-medium term. We estimate the company's earnings to grow at 11.7% CAGR (vs. 13.4% estimated before) while maintaining the sales CAGR at 6.6% over FY22-FY25E. We value the company's shares at 21.0x its (vs. 22.3x before) FY2025 EPS estimate and arrive at a PT of Rs. 1,158 (Rs. 1,210 before), and maintain our Hold rating as at the CMP, the stock indicates a 12% upside over the next 12 months.

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	FY2025E
Net sales	19,159.6	21,763.3	22,331.7	25,836.0	29,951.0
OPM (%)	22.2	20.9	22.4	22.3	22.5
Reported PAT	2,388.0	2,546.8	2,990.2	3,694.6	4,428.9
EPS (Rs)	29.8	34.0	37.7	46.2	55.2
PER (x)	38.5	33.7	30.4	24.8	20.8
EV/Ebidta (x)	22.0	20.1	18.3	15.8	13.2
P/BV (x)	5.0	4.4	3.9	3.4	2.9
ROCE (%)	16.6	17.2	18.0	18.7	19.7
RONW (%)	13.9	14.6	13.7	14.7	15.2
RONW (%)	10.1	13.9	14.6	13.8	15.3

Source: Company; Sharekhan estimates

India lagged, while North America clocks strong growth – mid-single digit revenue growth; margins expand on y-o-y and QoQ basis: The revenue grew at 6.0% y-o-y (-0.3% q-o-q) to Rs. 5,810 Crore It was driven by 1.8% y-o-y and a flat growth QoQ in India revenue (44.1% of revenue) to Rs. 2,563 Crore (~11.0% below our expectations), strong 42.3% YoY (+11.7% q-o-q) growth in North America revenue (27.5%) to Rs. 1,600 Crore (in line with our expectations), 3.3% y-o-y (-0.1% QoQ) rise in international markets revenue (13.1%); partially offset by 23.8% y-o-y (-21.6% q-o-q) decline in SAGA revenue (11.7%) to Rs. 680 crore, while Africa revenue (80.9% of SAGA) declined 11.7% y-o-y (-8.0% q-o-q) to Rs. 550 Cr and a 2.6% YoY (-3.9% q-o-q) decline in API revenue to Rs. 147 crore. (2.5%).

India revenue disappoints: India revenue, excluding COVID 19 sales, grew at 11.0% y-o-y, as it experienced growth in respiratory, cardiac, and anti-diabetic in core portfolio. The company witnessed the seventh consecutive quarter of market beating growth in its core portfolio across respiratory, anti-infectives, cardiac, and anti-diabetic y-o-y in Q3FY2023. At the same time, its consumer business has been faring well. In India it contributed 13.0% of its revenue (6.0% of total revenue) for 9MFY2023 as its flagship brands such as Omnigel, ORS, Cofsils, CIPCAL, nicotex, Cipladine, Cheston, Clocip in India grew at strong rate of 5.0-36.0% YoY for 9MFY2023.

North America revenue grows at a strong rate: The revenue grew at a stronger pace of 42.3% YoY (+11.7% q-o-q) in rupee terms and at a 30.0% YoY (8.9% q-o-q) rate in $ terms to $ 195 million in Q3FY2023. This was driven by expansion in the share of its complex products or differentiated products, which has also been able to offset the effect of the pricing erosion in its base products. Its recently launched respiratory products such as Albuterol and Arformoterol witnessed 170 bps y-o-y rise in market share to 17.6% and Arformoterol' s market share increased by 1%-point y-o-y to 38.5% in Q3FY2023. Lanreotide injection has also been witnessing exponential rise from 1.9% in Q4FY2022 to 14.1% in Nov 2022. The company has a strong line up of peptide, respiratory and complex assets for launches from FY2024-FY2027E as well, which can help it sustain the growth in North America revenue.

Strong pipeline of products in North America: The company has 160 approved ANDAs, 19 TAs and 74 ANDAs and NDAs are under process as of Q3FY2023. In total the company has 253 ANDAs and NDAs as of Q3FY2023.

SAGA impacted by fall in tender business: In South Africa, the company witnessed fall in tender business revenue to $12 million in Q3FY2023 from $23 million in Q3FY2022 and other business revenue declined to $16 mn in Q3FY2023 from $36 million in Q2FY22 as the company is witnessing evolving business mix challenges between private and tender business segments. Nevertheless, the company is witnessing strong demand in private markets, which are growing faster than the overall market. The company continues to maintain strong position in key therapy areas of Asthma and COPD, anti-biotics, cough & cold and probiotics.

Profitability peaks over several quarters with likely improved products mix: The company witnessed gross profits growing at 14.1% YoY (+3.7% QoQ) to Rs. 3,805.8 crore. and gross margins expand by 462 bps y-o-y and 257 bps QoQ to 65.5% (+350 bps above our estimate) in Q3FY2023. It was due to a strong products mix it has been able to achieve with the growth in its branded markets and differentiated products portfolio performing in the North America market. EBITDA grew at 14.3% y-o-y (+8.1% QoQ) to Rs. 1,407.6 crore while EBITDA margins improved 176 bps y-o-y and 188 bps q-o-q to 24.2% (in line with our estimate) in Q3FY2023. However, as the interest costs and taxes increased YoY and QoQ, the PAT increased at a slower pace of 9.9% y-o-y (+1.5% q-o-q) to Rs. 801 crore (7.5% below our estimate) in Q3FY2023.

Key concall highlights

- **Margin expansion:** It is driven by growth in its branded markets and increased contribution from its differentiated products portfolio in North America and mix change; partially offset by increased R&D spends, macroeconomic headwinds and SAGA underperforming.
- **Raw materials costs rise while freight cost improve QoQ:** As a result of improving fright rates and logistics mix, which is reassuring.

- **North America revenue:** It was the highest ever quarterly revenue reported as a result of strong traction in differentiated products, and market share gain in key respiratory and peptide injectable products. Lenalidomide's revenue was marginally lower QoQ in Q3FY2023. Peptide products' sales are tracking well.
- **Product pipeline in North America:** Lanreotide injection is on track to achieve 15.0% market share guidance in the category by the end of FY2023. Launch of Leuprolide injection in Q3FY2023 enhances its peptide portfolio further. Expects to continue to grow from the recent launches over the next 1 year and beyond. Clinical trials of key respiratory assets and filings of complex products including peptide injectables is on track.
- **Goa site:** Continues to communicate with the USFDA to get it cleared. Is about to de-risk key assets from the site and will share the details in some time. Abraxane is being filed from it. If the site gets the USFDA clearance it will be launched in H2FY2024.
- **ROIC:** Trailing 12-month ROIC stood at 19.7%, which is at the higher end of the 17-20% target it has.
- **R&D spend:** Stood at Rs. 363 Crore or 6.2% of revenue in Q3FY2023. The R&D spend has been 1.75%, incrementally of the revenue and profits, due to continued investments in respiratory, biosimilars, and other projects. To increase gradually in the coming quarters.
- **Exceptional costs:** Adjusted PAT stood at Rs. 876 Crore after one time charge towards reversal of deferred tax assets
- **ETR:** normalized ETR stands at 27.5%
- **Long term debt:** Comprises of ZAR 725 mn in South Africa and working capital loans of $ 49 mn in the US.
- **Consumer business:** Contributes 8.5% of the revenue including India and South Africa markets, as of Q3FY2023, and India consumer business to be Rs. 1,100 Cr revenue by the end of FY2023.
- **India:** The company launched over 10 new products in India in cardiac, anti-diabetic and injectables. Trade generics segment volumes growing at a strong pace with demand emerging from Tier II and rural markets. India segment had Rs. 200 Cr of COVID sales in India in Q3FY2022 and excluding it the segment revenue will be 11% y-o-y in Q3FY2023.
- **Advair:** Target action date is first week of April 2023. Minor query letter was responded to in the second cycle of review. Pre-Approval-Inspection (PAI) inspection for the product is over though.
- **Lenalidomide:** The players may not be able to satisfy generic demand fully over next 1 – 2 years as the launch is limited quantity and hence may not be too competitive.
- **SAGA:** Tender business is challenging. However, the market growth has slowed due to supply chain issues. Resumption likely from Q1FY2024.
- **Growth levers in the near future:**
  - Continuing market beating growth in India, reaching profitability levels of 21%-22% on a full year basis, robust traction in North America portfolio with continued contribution from respiratory and peptide products, incubate and drive growth in international markets with focus on core market and managing the growth in emerging markets.
  - Margins to moderate down in Q4FY2023 due to seasonality as Q3FY2023 the buying in the US is strongest among all FY quarters. To maintain strong product launches to drive growth.
  - To accelerate ROIC. To drive growth in India business by building big prescription brands in chronic therapies, enhance trade generics and global consumer businesses.
  - Sustained growth in the US with maximum contribution from differentiated products revenue.
  - Continued focus on costs and pricing.

Results (Consolidated) Rs cr

Particulars	Q3FY2023	Q3FY2022	YoY %	Q2FY2023	QoQ %
Net Revenue	5,810.1	5,478.9	6.0	5,828.5	-0.3
Raw materials costs	2,004.3	2,143.4	-6.5	2,160.2	-7.2
Gross Profit	3,805.8	3,335.5	14.1	3,668.4	3.7
Operating Expenses	2,398.2	2,104.5	14.0	2,366.0	1.4
EBIDTA	1,407.6	1,231.0	14.3	1,302.3	8.1
Depreciation	272.1	247.1	10.1	299.4	-9.1
EBIT	1,135.4	983.8	15.4	1,003.0	13.2
Interest	31.8	20.7	53.9	25.6	24.5
Other income	114.4	91.3	25.4	123.0	-6.9
PBT	1,218.1	1,054.4	15.5	1,100.4	10.7
Tax	410.0	295.2	38.9	302.6	35.5
Reported PAT before MI	808.1	759.3	6.4	797.8	1.3
Minority interests	6.9	28.3	-75.7	8.5	-19.3
Share of P/L of associates	-0.2	-2.1	-89.4	-0.4	-37.1
Reported PAT	801.0	728.9	9.9	788.9	1.5
Reported EPS (Rs)	9.9	9.0	10.0	9.8	1.4
Margins			**bps**		**bps**
GPM (%)	*65.5*	*60.9*	*462*	*62.9*	*257*
EBITDA (%)	*24.2*	*22.5*	*176*	*22.3*	*188*
Adj. profit margin (%)	*13.8*	*13.3*	*48*	*13.5*	*25*
Tax Rates (%)	33.7	28.0	567	27.5	616

Source: Company; Sharekhan Research

Geographical Sales Break-Up Rs cr

Geography Mix	Q3FY2023	Q3FY2022	YoY %	Q2FY2023	QoQ %
India (Rx+Gx+CHL)	2,563	2,518	1.8	2,563	0.0
North America	1,600	1,124	42.3	1,432	11.7
SAGA	680	892	-23.8	867	-21.6
Africa	550	623	-11.7	598	-8.0
International Markets	762	738	3.3	763	-0.1
API	147	151	-2.6	153	-3.9
Others	58	56	3.6	51	13.7
Total	**5,810**	**5,479**	**6.0**	**5,829**	**-0.3**

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 – Weak outlook on margins in short – medium term

Cipla's has seen an increase in the US's revenue base to $ 195 million a quarter vs. an average base of $ 155 million, before, driven by differentiated products. While its differentiated products comprising of respiratory and peptide products are performing well in the US, some of the concerns are that 8 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, slower India market growth, re-investments in the business with increased R&D and promotional investments, products partnerships may now allow the margin expansion at even higher levels. The company will see new spurt of growth for the US market from biosimilars launches, between 2028-2030 only, until then it has set of complex generic, peptide products to drive growth besides recently launched products in the interim.

Valuation – Maintain Hold with revised PT of Rs. 1,158

The company has witnessed strong growth in the North America markets, driven by higher share of complex and differentiated products such as Albuterol and Arformoterol and peptide injectables such as Lanreotide injection and Leuprolide depot injection, gaining market share. While some of the key products such as Abraxane and Advair are pending USFDA clearances for their launches, the company expects the recently launched products can sustain the sales momentum in the US over short – medium term. India and SAGA business posting strong growths will be key trigger for any re-rating for Cipla, going forward. We reduce our earnings estimates as the margins momentum is unlikely to sustain due to increased R&D, marketing and promotional investments, and partnered products, in short-medium term. We estimate the company's earnings to grow at 11.7% CAGR (vs. 13.4% estimated before) while maintaining the sales CAGR at 6.6% over FY22-FY25E. We value the company's shares at 21x its (vs. 22.3x before) FY25 EPS estimate and arrive at a PT of Rs. 1,158 (Rs. 1,210) before, and maintain our Hold rating as at the CMP, the stock indicates a 12% upside over the next 12 months.

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Cipla	1,035.25	80.7	83,545	30.4	24.8	20.8	18.3	15.8	13.2	13.7	14.7	15.2
Strides Pharma Science	322.65	7.5	2,423	69.0	11.6	8.3	10.5	6.8	5.4	1.8	9.8	12.4
Torrent Pharma	1,556.75	33.8	52,680	37.7	31.2	26.1	20.3	16.9	14.3	21.8	22.9	23.4

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. The recently launched complex and differentiated products have done extremely well in the US; however, the India market continues to post subdued sales growth. At the same time, International and SAGA is grappling with macro headwinds leading revenue weakness. This coupled with its key launches standing pending due to USFDA facility clearances, its expected increase in R&D and marketing and promotional investments and partnered products may not support consistently higher margins going forward. Any turnaround in India and SAGA business will be the key monitorable.

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	4.65
2	Blackrock Inc.	3.45
3	Government Pension	2.48
4	Vanguard Group Inc.	2.43
5	Norges Bank	2.30
6	Life Insurance Corp	2.29
7	Government Pension Fund	2.25
8	HDFC AMC	1.83
9	NPS Trust AC	1.60
10	GQG Partners	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

Sharekhan

by BNP PARIBAS

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