



Pharmaceuticals

Sharekhan code: CIPLA

Reco/View: Hold

CMP: Rs. 930

Price Target: Rs. 1,030



Upgrade



Maintain



Downgrade

3R MATRIX

	+	=	-
Right Sector (RS)	Green	Grey with check	Red
Right Quality (RQ)	Green with check	Grey	Red
Right Valuation (RV)	Green	Grey with check	Red

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	Grey	↔	Grey
RQ	Green	↔	Green
RV	Green	↓	Grey

ESG Disclosure Score **NEW**

ESG RISK RATING	28.4			
Updated Apr 13, 2023				
Medium Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

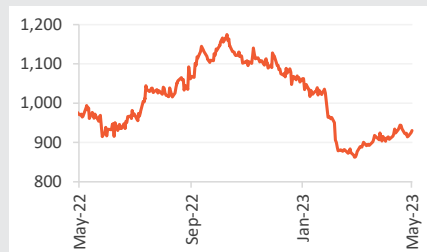
Company details

Market cap:	Rs. 75,097 cr
52-week high/low:	Rs. 1185 / 852
NSE volume: (No of shares)	15.8 lakh
BSE code:	500087
NSE code:	CIPLA
Free float: (No of shares)	53.6 cr

Shareholding (%)

Promoters	33.6
FII	1.3
DII	22.1
Others	43.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.7	-3.1	15.0	-4.1
Relative to Sensex	-2.2	-7.1	14.2	-18.3

Sharekhan Research, Bloomberg

Summary

- Cipla's Q4FY2023 numbers was a mixed bag as it outperformed our expectations on the revenue front as revenue of ~Rs. 5,739 Cr was above our estimate of Rs. 5,565.1 Cr. while EBITDA came in line at ~Rs. 1,174 Cr vs. our estimate of Rs. 1,169 Cr and adjusted PAT was slightly below estimates at ~Rs. 653.7 Cr vs. our estimate of ~Rs. 673.0 Cr.
- Some of Cipla's key facilities continue to languish under the USFDA scanner such as Indore and Goa. India segment revenue continue to grow at a tepid pace due to high base effect associated with COVID 19 sales.
- R&D spend is expected to continue to rise due to a likely increase in spend on differentiated portfolio of products and biosimilars, which restricts the likelihood of EBITDA margin expansion over the short - medium term.
- We reduce the PT to Rs. 1030 (vs. before Rs. 1,080) and maintain HOLD on it as it trades at ~22.0x and ~19.0x its FY24 and FY25E EPS estimates vs. peers trading at ~18.3x and ~16.1x its FY24E and FY25E EPS estimates, indicating higher valuation.

Cipla's Q4FY2023 was a mixed performance. The revenue rose by ~9.1% y-o-y to Rs. 5,739 Cr. It was largely led by India growing at a slower pace of ~3.5% y-o-y to ~Rs. 2,259 Cr due to higher COVID 19 sales in its Q4FY22 revenue base; ~12.7% y-o-y decline in South Africa revenue to Rs. 832 Cr due to supply challenges; partially offset by strong growth in North America's revenue at ~38.7% y-o-y rise to Rs. 1,677 Cr. driven by market share expansion in its key launches such as gLanreotide and gRevlimid and ~7.1% y-o-y rise in emerging market revenue to ~Rs. 784 Cr. It was the highest ever sales for the North America market. R&D costs also increased ~15.0% y-o-y to Rs. 371 Cr (~6.5% of sales) due to continued progress of clinical trials on key pipeline products. The EBITDA rose at ~21.0% y-o-y to Rs. 1,174 Cr due to ~106 bps y-o-y increase in gross profits margins to ~64.0%. The adjusted PAT increased at ~10.7% y-o-y to ~Rs. 708.1 Cr.

Key positives

- US sales grew at a strong pace of ~38.7% YoY in Q4FY23
- India business grew at ~16.0% y-o-y on a COVID 19 adjusted basis while Industry grew at ~8.0% as per IQVIA.

Key negatives

- Continued slower growth in India market over the last 3 quarters due to COVID 19 related high base effect.
- Likely increase in R&D spend and marketing and promotions and partnered products' likely be weighing on margins.

Management Commentary

- The company has guided for EBITDA margin of ~22.0% for FY24E.
- The impact of price cut due to NLEM has already been incorporated in Q4FY23 numbers. However, the impact of the price hike will be seen from Q2FY24 onwards. For the consumer business the company has guided for mid - teens EBITDA margin in FY24E.
- Gross margin expansion was driven by new launches and favorable products mix while R&D costs stood at ~6.5% of the revenue. The company has guided R&D to be ~6-6.5% of revenue.

Revision in Estimates - We have cut our EPS estimates by ~9.0% and ~11.0% for FY23E and FY24E, respectively, to account for flattish expectations in profitability.

Our Call

View - Maintain Hold with revised PT of Rs. 1030: The company posted mixed results in Q4FY23 due to slower growth in India and a decline in South Africa revenue; partially offset by a strong growth posted in North America revenue. The EBITDA margins are expected to remain flat in FY24E due to increased spending towards innovative products and biosimilars. We cut the EPS estimates by ~9.0% and ~11.0% for FY24E and FY25E EPS, respectively and reduce the PT to Rs. 1030 (vs. before Rs. 1,080) and maintain HOLD on it as it trades at ~22.0x and ~18.9x its FY24 and FY25E EPS estimates vs. peers trading at ~18.3x and ~16.1x its FY24E and FY25E EPS estimates, indicating higher valuation.

Key Risks

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)

Particulars	FY21	FY22	FY23	FY24E	FY25E
Net sales	19,159.6	21,763.3	22,753.1	25,448.3	28,670.0
Operating Profits	4252.4	4552.8	5027.0	5521.6	6220.6
OPM (%)	22.2	20.9	22.1	21.7	21.7
Reported PAT	2,404.9	2,698.9	2,984.3	3,405.4	3,959.5
EPS (Rs)	29.8	33.5	37.0	42.2	49.1
PER (x)	31.2	27.8	25.1	22.0	18.9
EV/Ebitda (x)	17.4	16.3	14.8	13.4	11.9
P/BV (x)	4.0	3.6	3.2	2.8	2.5
ROCE (%)	15.8	16.0	15.7	15.5	16.1
RONW (%)	12.9	12.8	12.6	12.8	13.2

Source: Company; Sharekhan estimates

Key concall highlights:

- ◆ **India market:** India business grew at 16.0% y-o-y on a COVID 19 adjusted basis while Industry grew at 8.0% as per IQVIA. Chronic contribution was at 59.0% of the portfolio, up 300 bps y-o-y. The company launched 50 new products in India. The impact of price cut due to NLEM has already been incorporated in Q4FY23 numbers. However, the impact of the price hike will be seen from Q2FY24 onwards. For the consumer business the company has guided for mid – teens EBITDA margin in FY24E.
- ◆ **US market:** Respiratory revenue was at USD 160.0 million for FY23 while Lanreotide' s market share stood at ~17.0% and is likely to increase gradually. The filings for differentiated portfolio is targeted for FY24E. The Indore facility has been inspected by the USFDA and the impact of the same would be known by Mid – May 202 from where the company plans to file its gAdvair. The company is in the process to shift the filing of gAdvair to a facility outside of India to de-risk from any adverse outcome for the Indore facility. The Goa facility is awaiting completion of correcting actions and preventive actions (CAPA) and expects it to be over by Q1FY24. gAbraxane is expected to be launched by FY25E. Albuterol is growing constantly.
- ◆ **Profitability:** Gross margin expansion was driven by new launches and favorable products mix while R&D costs stood at 6.5% of the revenue. The company has guided R&D to be 6-6.5% of revenue. The company has guided for EBITDA margins of ~22.0% due to higher spending on innovative products and biosimilars.

Results (Consolidated)

	Rs cr				
Particulars	Q4FY23	Q4FY22	YoY %	Q3FY23	QoQ %
Net Revenue	5,739.30	5,260.33	9.11	5,810.09	-1.22
Raw materials costs	2,063.37	1,946.70	5.99	2,004.30	2.95
Gross Profit	3,675.93	3,313.63	10.93	3,805.79	-3.41
Operating Expenses	2,502.19	2,343.91	6.75	2,398.24	4.33
EBIDTA	1,173.74	969.72	21.04	1,407.55	-16.61
Depreciation	346.22	290.31	19.26	272.11	27.24
EBIT	827.52	679.41	21.80	1,135.44	-27.12
Interest	34.36	18.10	89.83	31.82	7.98
Other income	134.63	64.02	110.29	114.44	17.64
PBT	927.79	725.33	27.91	1,218.06	-23.83
Tax	222.25	71.11	212.54	410.01	-45.79
Reported PAT before MI	705.54	654.22	7.84	808.05	-12.69
Exceptional items	182.40	277.50	-34.27	0.00	NM
Minority interests	-4.14	8.63	-147.97	6.87	-160.26
Share of P/L of associates	-1.61	-6.02	-73.26	-0.22	631.82
Reported PAT	525.67	362.07	45.18	800.96	-34.37
Reported EPS (Rs)	6.52	9.93	-34.37	4.48	45.53
Adjusted PAT	708.07	639.57	10.71	800.96	-11.60
Margins			bps		
GPM (%)	64.05	62.99	105.56	65.50	-145.47
EBITDA (%)	20.45	18.43	201.63	24.23	-377.50
Profit margin (%)	9.16	6.88	227.61	13.79	-462.65
Tax Rates (%)	23.95	9.80	1,415.10	33.66	-970.61

Source: Company, Sharekhan Research

Geographical Sales Break-Up

	Rs cr				
Particulars	Q4FY23	Q4FY22	YoY %	Q3FY23	QoQ %
India (Rx+Gx+CHL)	2,259.00	2,183.00	3.5	2,563.00	-11.86
North America	1,677.00	1,209.00	38.7	1,600.00	4.8
SAGA	832.00	953.00	-12.7	680.00	22.4
International Markets	784.00	732.00	7.1	762.00	2.9
API	134.00	137.00	-2.2	147.00	-8.8
Others	53.00	46.00	15.2	58.00	-8.6
Total	5,739.00	5,260.00	9.1	5,810.00	-1.2

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Regulatory concerns and pricing erosion prove a hurdle over the short-medium term.

Over the years, Indian pharmaceutical companies have established themselves as a dependable source for global pharma companies. The confluence of other factors, including a focus on specialty/complex products in addition to emerging opportunities in the API space, would be key growth drivers over the long term. However, ongoing USFDA plant inspections and a few companies being issued Form 483 with observations point at apparent regulatory concerns. We believe in the near term, based on the headwinds that may drag the performance, especially in the API and CDMO space and for large pharma players seeing USFDA OAI or WL status on their facilities, we have a Neutral view of the sector.

■ Company outlook - Positive outlook over long term

Cipla's has seen an increase in the US's revenue base to USD 195 million a quarter vs. an average base of USD 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 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, 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 a 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. 1030

The company posted mixed results in Q4FY23 due to slower growth in India and a decline in South Africa revenue; partially offset by a strong growth posted in North America revenue. The EBITDA margins are expected to remain flat in FY24E due to increased spending towards innovative products and biosimilars. We cut the EPS estimates by ~9.0% and ~11.0% for FY24E and FY25E EPS, respectively and reduce the PT to Rs. 1030 (vs. before Rs. 1,080) and maintain HOLD on it as it trades at ~22.0x and ~18.9x its FY24 and FY25E EPS estimates vs. peers trading at ~18.3x and ~16.1x its FY24E and FY25E EPS estimates, indicating higher valuation.

Peer Comparison

Companies	CMP (Rs / Share)	MCAP (Rs Cr)	P/E (x)			EV / EBITDA (x)			RoE (%)		
			FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Cipla	930.40	75,083	25.1	22.0	18.9	14.8	13.4	11.9	12.6	12.8	13.2
Dr. Reddy's	4,460.55	74,280	17.1	15.3	14.3	9.1	10.2	8.3	17.5	16.9	15.8
Zydus Life	507.45	51,364	20.8	18.9	17.0	13.5	11.9	11.6	14.1	13.9	13.7

Source: Company; Sharekhan Research

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 to 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

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

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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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