

Cipla

6 November 2018

Reuters: CIPL.NS; Bloomberg: CIPLA IN

Constrained Funding Environment impacts Tender Business

Cipla's revenue of Rs40,119mn in 2QFY19 were down 2% YoY and up 2% QoQ and below our/consensus estimates by 2.2%/6.5%, respectively. Revenues were lower as SAGA (South Africa, Sub-Sahara and Global Access) business faced a steep decline of 18% YoY and 10% QoQ. The decline was primarily because of a weak funding environment which impacted tender volume and prices.

EBITDA for the quarter stood at Rs7,530m (18.8% of sales) and was down 6% YoY but up 4% QoQ. Net earnings decline was steeper (15.6% YoY and 17.7% QoQ) because of higher depreciation and amortisation/impairment expenses which was up 17% QoQ. The depreciation and amortisation line item continues to be volatile. Besides, other expenses were also higher at 10.3% QoQ. Part of the rise in other expenses was led by an increase in R&D expenses pertaining to Advair clinical trials. R&D expenses during the quarter increased from Rs2,780mn to Rs3,160mn on QoQ basis.

The US business, which is supposed to drive a lion's share of forecasted earnings growth, stood at US\$108mn (up 8% QoQ). The ramp-up is yet to reflect the upside from recent limited-competition drug launches like (Albendazole, Diclofenac gel, Testosterone Cypionate and Metoprolol Succinate) which together can add US\$90mn to the US sales annually. Hence, the US sales should reach a quarterly run-rate of US\$130mn once these launches ramp up to their full potential (around 1QFY20E). The US business should allow EBITDA expansion of 20% from current level by 1QFY20E.

Outlook and valuation: We have revised our estimates to include the impact of Indian rupee or INR depreciation, lower SAGA sales and adjusting our forecasts for depreciation and amortisation expenses. We have revised our target price on Cipla to Rs657 (647 earlier) as we have rolled over the valuation to September quarter FY21E EPS at 22x P/E multiple. We have upgraded our rating on the stock to Buy (from Accumulate earlier).

BUY

Sector: Pharmaceuticals

CMP: Rs563

Target Price: Rs657

Upside: 17%

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Key Data

Current Shares O/S (mn)	805.2
Mkt Cap (Rsbn/US\$bn)	452.9/6.2
52 Wk H / L (Rs)	678/507
Daily Vol. (3M NSE Avg.)	2,662,770

Price Performance (%)

	1 M	6 M	1 Yr
Cipla	(11.6)	(5.8)	(12.1)
Nifty Index	2.1	(0.8)	0.7

Source: Bloomberg

Y/E March (Rsmn)	2QFY18	1QFY19	2QFY19	YoY (%)	QoQ(%)	1HFY18	1HFY19	YoY (%)
Revenues	40,824	39,390	40,119	(1.7)	1.9	76,075	79,509	4.5
Raw material costs	15,531	14,239	14,121	(9.1)	(0.8)	27,298	28,361	3.9
% of revenues	38.0	36.1	35.2	(284) bps	(95) bps	36.8	38.2	143 bps
Staff costs	6,608	7,140	7,122	7.8	(0.2)	13,338	14,262	6.9
% of revenues	16.6	18.6	18.0	147 bps	(52) bps	17.1	18.3	119 bps
R&D expenses	2,510	2,780	3,160	25.9	13.7	4,630	5,940	28.3
% of revenues	6.1	7.1	7.9	173 bps	82 bps	6.2	8.0	177 bps
Other expenses	8,131	7,967	8,693	6.9	9.1	16,301	16,661	2.2
% of revenues	20.4	20.7	22.0	163 bps	130 bps	22.0	22.5	48 bps
EBITDA	8,044	7,264	7,022	(12.7)	(3.3)	14,509	14,286	(1.5)
EBITDA margin (%)	19.7	18.4	17.5	(220) bps	(94) bps	19.6	19.3	(30) bps
Other income	1,133	1,701	1,326	17.0	(22.1)	2,647	3,027	14.3
Interest costs	420	351	444	5.6	26.4	699	795	13.7
Depreciation	3,022	2,410	2,819	(6.7)	17.0	5,157	5,229	1.4
PBT	5,735	6,204	5,085	(11.3)	(18.0)	11,300	11,289	(0.1)
Tax	1,374	1,737	1,424	3.6	(18.0)	2,682	3,161	17.9
Tax rate (%)	24.0	28.0	28.0	404 bps	0 bps	23.7	28.0	427 bps
Reported PAT	4,348	4,456	3,669	(15.6)	(17.7)	8,437	8,125	(3.7)
PAT Margin (%)	10.7	11.3	9.1	(151) bps	(217) bps	11.1	10.2	(87) bps

Source: Company, Nirmal Bang Institutional Equities Research

Earnings call commentary

Gross margin: Gross margin expansion seen during the quarter was mainly on account of improved product mix, cost optimisation programmes and momentum in the US portfolio.

Domestic business: In 2QFY19, growth was subdued on account of a high base last year because of Goods and Services Tax or GST-led restocking. Additionally, the acute season was delayed, which may have had an impact of Rs600mn-Rs700mn. Adjusted for GST, the business grew 13% in 1HFY19, YoY.

API business: Growth in 2QFY19 appears to be subdued on account of a high base last year.

Pressure on tender business: Around one-third of emerging markets or EMs, 40% of South Africa and almost entire Global Access business is driven by tenders. The quarter witnessed delayed offtake in South Africa and some EMs were under pressure. The global funding environment has been severely constrained which led to the decline in tender-driven business. Government-funded tender businesses are affected by liquidity position of the government. A rebasing of Cipla Global Access business was observed, with a possible annual impact of US\$80mn. Most of the Global Access business portfolio is commoditised and the company is working on rejuvenating the same. Largely, ARV/malaria are the therapies affected in this space. Funding constraints have impacted the volume of this business, while pricing is generally affected by the number of players in the market.

Supply problems: Cipla is currently rebalancing the capacity at some of its facilities in India. This can have a short-term top-line impact of around Rs1,000mn per quarter. Considering that most of these products are the ones with significant margins, around 50%-60% of the top-line will flow to PBT.

US business: There are three parts to Cipla's US business. Invagen has been fairly stable. B2B business has seen a fast decline because of pricing pressure in the US. DTM business has done well, contributing around 40% of the US revenues during the quarter. Cipla has been able to achieve around 90%-95% of its target for the DTM business. Going forward, the company will concentrate on the institutional space, CNS and respiratory therapies in this geography. It may be able to commercialise one or two of its assets in the next two years. Currently, this business is negative on the post R&D EBITDA front, but is close to break-even. Portfolio rationalisation, which is now complete, also had an impact on the US revenues.

Top products in US business: Gabapentin, Bupropion and Pulmicort together contribute around 15% to the US revenues.

Proventil: The company is on track with its work on Proventil. While initially it had given guidance about the launch in 1HFY20, it may get delayed by around three to four months. This could be a limited-competition product with around one to two players.

Biosimilars: Cipla is witnessing good momentum in biosimilars in the EM space. It has signed an in-licensing and marketing deal with Sri Lanka and Nepal for the biosimilar, Bevacizumab.

Tax rate: Expect effective tax rate of 28% for FY19.

US ANDA filing and approval: Maintains the target of 20 plus ANDA filings during FY19 and expects to launch one limited-competition product per quarter. The company is also aiming at launching one inhaler per year. It is looking at specialty business/505 (b) (2) filings as well.

2HFY19 guidance: Cipla expects its performance in the second- half of FY19 to be flattish, given the headwinds in the form of tender problem, capacity rebalancing impact, sanctions problem, commodity and crude oil price inflation and escalation of tariff war in China. It expects to maintain profitability at the current level.

FY20: Growth could be driven by outperformance in private markets and annual impact of product launches in the US. Cost rationalisation will continue to drive profitability.

Exhibit 1: Actual versus our estimate and Bloomberg consensus estimate

(Rsmn)	Actual	NBIE estimate	Var.(%)	Cons. estimate	Var.(%)
Sales	39,390	42,832	(8.0)	40,274	(2.2)
EBITDA	7,264	8,909	(18.5)	7,734	(6.1)
EBITDA margin (%)	18.4	20.8	(236bps)	19.2	(76bps)
Reported PAT	4,456	4,844	(8.0)	3,840	16.0

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Key financials

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Net sales	1,46,302	1,52,193	1,69,992	1,86,769	2,03,069
EBITDA	24,758	28,264	35,362	41,761	45,223
Net profit	10,424	14,194	17,672	22,622	25,456
EPS (Rs)	12.9	17.6	21.9	28.1	31.6
EPS growth (%)	(25.2)	36.8	24.5	28.1	12.5
EBITDA margin (%)	16.9	18.6	20.8	22.4	22.3
P/E (x)	43.7	31.9	25.7	20.0	17.8
P/BV (x)	3.6	3.2	2.8	2.5	2.2
EV/EBITDA (x)	19.7	17.1	13.1	10.7	9.5
RoCE (%)	8.5	10.0	13.5	15.6	15.7
RoE (%)	8.3	10.0	11.1	12.5	12.4

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Change in our estimates

Rsmn	New estimates		Old estimates		Change (%)	
	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Net sales	1,69,992	1,86,769	1,68,922	1,85,645	0.6	0.6
EBITDA	35,362	41,761	34,662	41,013	2.0	1.8
Margin (%)	20.8	22.4	20.5	22.1	28 bps	27 bps
PAT	17,644	22,594	18,525	23,518	(4.8)	(3.9)
Margin(%)	10.4	12.1	11.0	12.7	(59) bps	(57) bps
EPS	21.9	28.1	23.0	29.2	(4.8)	(3.9)

Exhibit 4: Quarterly revenue details

Segmental revenues (Rsmn)	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19
India (Rx+Gx)	14,690	13,980	11,940	12,710	16,460	16,010	13,530	15,440	16,440
North America	6,640	6,620	6,460	6,460	6,180	6,500	6,750	6,700	7,580
South Africa, Sub-Saharan & Cipla Global Access business	8,780	8,200	8,190	7,500	9,210	8,700	8,190	8,310	7,540
Emerging markets	4,110	4,200	4,070	4,630	4,540	3,710	3,940	4,690	4,720
Europe	1,330	1,310	2,030	1,640	1,510	1,710	1,360	1,340	1,410
API	1,150	1,200	1,630	1,300	2,130	1,480	1,350	2,000	1,710
Others	810	970	1,500	1,010	800	1,030	1,860	910	720
Total	37,510	36,480	35,820	35,250	40,830	39,140	36,980	39,390	40,120
Revenue mix (%)	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19
India (Rx+Gx)	39.2	38.3	33.3	36.1	40.3	40.9	36.6	39.2	41.0
North America	17.7	18.1	18.0	18.3	15.1	16.6	18.3	17.0	18.9
South Africa, Sub-Saharan & Cipla Global Access business	23.4	22.5	22.9	21.3	22.6	22.2	22.1	21.1	18.8
Emerging markets	11.0	11.5	11.4	13.1	11.1	9.5	10.7	11.9	11.8
Europe	3.5	3.6	5.7	4.7	3.7	4.4	3.7	3.4	3.5
API	3.1	3.3	4.6	3.7	5.2	3.8	3.7	5.1	4.3
Others	2.2	2.7	4.2	2.9	2.0	2.6	5.0	2.3	1.8
*QoQ growth (%)	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19
India (Rx+Gx)	-	(4.8)	(14.6)	6.4	29.5	(2.7)	(15.5)	14.1	6.5
North America	-	(0.3)	(2.4)	-	(4.3)	5.2	3.8	(0.7)	13.1
South Africa, Sub-Saharan & Cipla Global Access business	-	(6.6)	(0.1)	(8.4)	22.8	(5.5)	(5.9)	1.5	(9.3)
Emerging markets	-	2.2	(3.1)	13.8	(1.9)	(18.3)	6.2	19.0	0.6
Europe	-	(1.5)	55.0	(19.2)	(7.9)	13.2	(20.5)	(1.5)	5.2
API	-	4.3	35.8	(20.2)	63.8	(30.5)	(8.8)	48.1	(14.5)
Others	-	19.8	54.6	(32.7)	(20.8)	28.8	80.6	(51.1)	(20.9)
Total	-	(2.7)	(1.8)	(1.6)	15.8	(4.1)	(5.5)	6.5	1.9
*YoY growth (%)	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19
India (Rx+Gx)	-	-	-	-	12.0	14.5	13.3	21.5	(0.1)
North America	-	-	-	-	(6.9)	(1.8)	4.5	3.7	22.7
South Africa, Sub-Saharan & Cipla Global Access business	-	-	-	-	4.9	6.1	-	10.8	(18.1)
Emerging markets	-	-	-	-	10.5	(11.7)	(3.2)	1.3	4.0
Europe	-	-	-	-	13.5	30.5	(33.0)	(18.3)	(6.6)
API	-	-	-	-	85.2	23.3	(17.2)	53.8	(19.7)
Others	-	-	-	-	(1.2)	6.2	24.0	(9.9)	(10.0)
Total	-	-	-	-	8.9	7.3	3.2	11.7	(1.7)

*Cipla had restructured its revenue presentation format from 2QFY17 onwards. Hence, certain YoY and QoQ numbers growth are not available.

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Quarterly snapshot

Particulars	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19
Margins (%)										
Gross profit	62.5	64.5	64.3	63.3	66.6	62.0	64.8	64.0	63.9	64.8
EBITDA	16.7	18.1	18.6	14.1	18.3	19.7	20.9	15.1	18.4	17.5
PAT	9.3	9.4	10.3	(1.8)	11.6	10.7	10.3	4.1	11.3	9.1

Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 6: Income statement

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Net sales	1,46,302	1,52,193	1,69,992	1,86,769	2,03,069
% growth	6.1	4.0	11.7	9.9	8.7
Raw material costs	53,171	54,384	58,647	62,568	68,028
Staff costs	26,338	26,901	29,322	32,548	36,453
R&D expenses	11,249	10,415	12,497	12,997	13,517
Other expenditure	30,787	32,229	34,163	36,896	39,847
Total expenditure	1,21,545	1,23,929	1,34,629	1,45,008	1,57,846
EBITDA	24,758	28,264	35,362	41,761	45,223
% growth	(0.2)	14.2	25.1	18.1	8.3
EBITDA margin (%)	16.9	18.6	20.8	22.4	22.3
Other income	2,287	3,577	628	1,389	2,156
Interest costs	1,594	1,142	928	825	733
Gross profit	93,131	97,808	1,11,345	1,24,201	1,35,041
% growth	7.0	5.0	13.8	11.5	8.7
Depreciation	13,229	13,228	10,418	10,805	11,191
Profit before tax & exceptional items	12,222	17,470	24,544	31,420	35,356
Exceptional items	-	775	-	-	-
Profit before tax	12,222	16,695	24,544	31,420	35,356
% growth	(29.2)	42.9	40.5	28.0	12.5
Tax	1,798	2,501	6,872	8,798	9,900
Effective tax rate (%)	14.7	14.3	28.0	28.0	28.0
PAT before MI/associates	10,424	14,194	17,672	22,622	25,456
Share of MI/associates	(70)	(28)	(28)	(28)	(28)
PAT after MI/associates	10,354	14,166	17,644	22,594	25,428
% growth	(25.3)	36.2	24.5	28.0	12.5
EPS (Rs)	12.9	17.6	21.9	28.1	31.6
% growth	(25.2)	36.8	24.5	28.1	12.5

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Balance sheet

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Equity	1,609	1,610	1,610	1,610	1,610
Reserves	1,23,828	1,40,682	1,57,623	1,79,515	2,04,241
Net worth	1,25,437	1,42,292	1,59,233	1,81,125	2,05,852
Minority interest	4,382	3,524	3,524	3,524	3,524
Net deferred tax liabilities	7,569	5,033	5,033	5,033	5,033
Short-term loans	4,672	4,359	6,046	6,536	7,106
Long-term loans	36,454	36,621	29,527	26,575	23,917
Other non-current liabilities	2,792	2,813	2,813	2,813	2,813
Liabilities	1,81,306	1,94,642	2,06,177	2,25,606	2,48,245
Net block	57,297	58,288	62,628	64,009	64,494
Intangible assets and goodwill	54,453	51,028	51,028	51,028	51,028
Other non-current assets	11,265	11,150	11,150	11,150	11,150
Inventories	34,853	40,447	43,617	46,533	50,594
Debtors	25,631	31,025	34,653	38,073	41,396
Cash	6,242	9,656	23,495	37,453	55,046
Other current assets	20,630	27,013	15,991	15,991	15,991
Total current assets	87,356	1,08,141	1,17,757	1,38,050	1,63,028
Creditors	15,711	21,191	22,852	24,380	26,508
Other current liabilities	13,353	12,772	13,533	14,249	14,946
Total current liabilities	29,065	33,964	36,385	38,629	41,453
Net current assets	58,291	74,178	81,372	99,421	1,21,575
Total assets	1,81,306	1,94,642	2,06,178	2,25,607	2,48,246

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Cash flow

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
EBIT	19,337	13,816	17,837	25,314	32,522
(Inc./dec. in working capital)	(5,388)	(414)	(12,473)	7,142	(4,460)
Cash flow from operations	13,948	13,401	5,364	32,457	28,062
Other income	(2,082)	(2,287)	(3,577)	(483)	(529)
Other expenses	6,685	(2,188)	(1,761)	-	-
Depreciation	7,542	13,229	13,228	9,380	9,755
Tax paid (-)	(3,316)	(1,798)	(2,501)	(6,072)	(7,899)
Net cash from operations	22,777	20,358	10,754	35,282	29,388
Capital expenditure (-)	(48,727)	(10,676)	(10,794)	(27,380)	(18,427)
Net cash after capex	(25,950)	9,681	(40)	7,903	10,961
Other investment activities	1,287	(412)	3,692	483	529
Cash from financial activities	27,734	(11,742)	(239)	(7,227)	(4,072)
Opening cash balance	5,643	8,714	6,242	9,656	10,815
Closing cash balance	8,714	6,242	9,656	10,815	18,233
Change in cash balance	3,071	(2,472)	3,414	1,159	7,418

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Key ratios

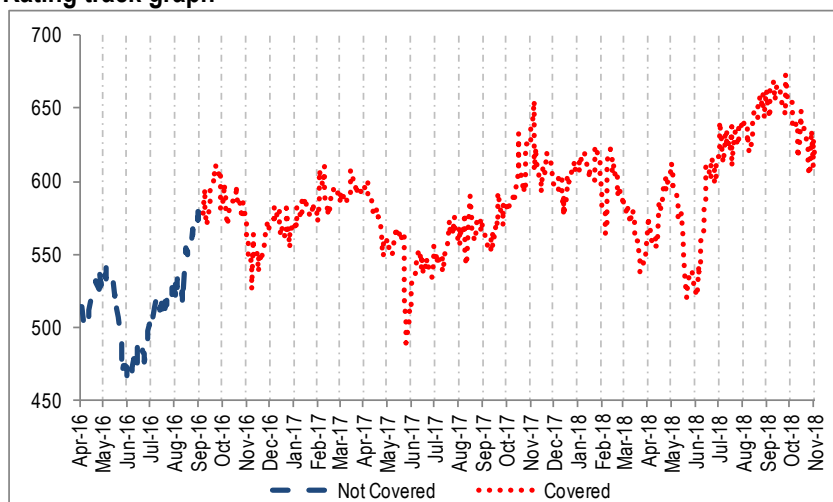
Y/E March	FY17	FY18	FY19E	FY20E	FY21E
Profitability & return ratios					
EBITDA margin (%)	16.9	18.6	20.8	22.4	22.3
EBIT margin (%)	9.4	11.7	15.0	17.3	17.8
Net profit margin (%)	7.1	9.3	10.4	12.1	12.5
RoE (%)	8.3	10.0	11.1	12.5	12.4
RoCE (%)	8.5	10.0	13.5	15.6	15.7
Working capital & liquidity ratios					
Receivables (days)	60.5	67.0	69.5	70.1	70.4
Inventory (days)	246.9	249.2	258.0	259.4	257.0
Payables (days)	103.1	122.1	135.2	135.9	134.6
Current ratio (x)	3.0	3.2	3.2	3.6	3.9
Quick ratio (x)	1.8	2.0	2.0	2.4	2.7
Valuation ratios					
EV/sales (x)	3.3	3.2	2.7	2.4	2.1
EV/EBITDA (x)	19.7	17.1	13.1	10.7	9.5
P/E (x)	43.7	31.9	25.7	20.0	17.8
P/BV (x)	3.6	3.2	2.8	2.5	2.2

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price	Target price (Rs)
9 February 2017	Buy	560	700
6 September 2016	Buy	577	700
10 November 2016	Buy	566	700
26 December 2016	Buy	582	700
9 February 2017	Buy	603	700
26 May 2017	Buy	504	684
8 November 2017	Buy	608	713
8 February 2018	Buy	569	716
23 May 2018	Buy	525	647
9 August 2018	Acc.	633	647
6 November 2018	Buy	563	657

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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