

Cipla

7 February 2019

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Temporary Disruptions Dilute The Impact of US Scale-up

Cipla's revenues of Rs40,075mn in 3QFY19 were up 2% YoY and down 1% QoQ and also below our/consensus estimate by 4.3%/2.7%, respectively. Net earnings at Rs3,320mn declined 12% QoQ and 17% YoY, despite revenues being flat QoQ. Earnings were 26%/9% below our/consensus estimate, respectively. The steep decline in net earnings was driven by some temporary disruptions such as:

- 1) Liquidation of inventory (closer to expiry) below cost and heavy discount in tender prices knocking off 150bps which translates to around Rs600mn by way of higher cost of sales.
- 2) High-margin domestic business was impacted by de-stocking in trade channels (up to six days) which impacted domestic market sales by 600bps (translating to Rs1,000mn in lower reported sales) and led to an estimated Rs700mn impact on EBITDA.
- 3) Manufacturing constraints impacted revenues to the extent of Rs1,000mn which, in our estimate, knocked off Rs400mn from EBITDA.

EBITDA at Rs7,200mn was below our/consensus estimate by 12%/5%, respectively. EBITDA adjusted for the above temporary disruptions that impacted Cipla's revenues during the quarter, would have been Rs1,700mn higher.

Outlook and valuation: We currently refrain from revising our estimates as we see the disruptions witnessed during the quarter as temporary and expect a normal performance from 1QFY20. The inventory liquidation happened as tender volume was lower than anticipated. The domestic channel de-stocking was a one-time event. The impact of raw material inflation is also factored into the numbers now and according to the company, tender business for it has now rebased and should not go down from here. The key businesses that are critical for long-term growth are shaping well.

- 1) The US business has turned around and is now EBITDA positive.
- 2) India business is showing strong growth (faster than IPM) and the share of chronic sales in the overall mix is rising. Cipla's chronic segment grew 19% during the quarter
- 3) South Africa private market sales are growing 4x the market growth.

We have retained our estimates on Cipla and also our target price of Rs657 based on 22x September FY21E EPS. We have also retained Buy rating on the stock.

BUY

Sector: Pharmaceuticals

CMP: Rs528

Target Price: Rs657

Upside: 24%

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Key Data

Current Shares O/S (mn)	805.7
Mkt Cap (Rsbn/US\$bn)	431/6.0
52 Wk H / L (Rs)	678/484
Daily Vol. (3M NSE Avg.)	2,634,716

Price Performance (%)

	1 M	6 M	1 Yr
Cipla	4.3	(16.1)	(5.2)
Nifty Index	3.1	(2.9)	5.4

Source: Bloomberg

Y/E March (Rsmn)	3QFY18	2QFY19	3QFY19	YoY (%)	QoQ(%)	9MFY18	9MFY19	YoY (%)
Revenues	39,138	40,119	40,075	2.39	(0.11)	115,213	119,584	3.79
Raw material costs	13,784	14,121	14,627	6.11	3.58	41,082	42,987	4.64
% of revenues	35.2	35.2	36.5	128bps	130bps	36.5	38.2	169bps
Staff costs	6,573	7,122	7,179	9.21	0.79	19,911	21,441	7.68
% of revenues	17.1	18.0	18.4	123bps	34bps	17.0	18.3	131bps
R&D expenses	2,975	3,160	2,990	0.52	(5.38)	7,605	8,930	17.43
% of revenues	7.6	7.9	7.5	(14bps)	(42bps)	6.8	7.9	118bps
Other expenses	7,620	8,693	8,203	7.66	(5.64)	23,921	24,864	3.94
% of revenues	19.9	22.0	21.0	113bps	(102bps)	21.3	22.1	84bps
EBITDA	8,187	7,530	7,200	(12.05)	(4.38)	22,695	21,363	(5.87)
EBITDA margin (%)	20.9	18.8	18.0	(295bps)	(80bps)	20.2	19.0	(118bps)
Other income	529	1,326	785	48.37	(40.76)	3,176	3,812	20.01
Interest costs	92	444	442	382.95	(0.41)	790	1,237	56.46
Depreciation	5,224	2,819	2,931	(43.88)	3.98	10,380	8,160	(21.38)
PBT	3,401	5,593	4,612	35.61	(17.54)	14,701	15,778	7.32
Tax	(642)	1,424	1,257	(295.67)	(11.74)	2,039	4,418	116.62
Tax rate (%)	(18.9)	25.5	27.3	4,614bps	179bps	13.9	28.0	1,413bps
Reported PAT	(9)	8	10	(210.34)	23.08	(191)	(3)	(98.48)
PAT Margin (%)	4,035	4,177	3,365	(16.60)	(19.44)	12,471	11,357	(8.93)

Source: Company, Nirmal Bang Institutional Equities Research

Earnings call commentary

Gross margin: Gross margin contraction witnessed during the quarter was mainly on account of inventory liquidation and price discount in the South Africa portfolio. In addition, the company lost sales amounting to Rs1,000mn because of manufacturing constraints which should be resolved by 1QFY20.

R&D: R&D spending on speciality pipeline will be capped around 1.5% of the revenues. The R&D costs arising because of Advair are expected to ease next year.

Domestic business: This business grew 12% YoY as per IQVIA, but reported sales were flat because of de-stocking in the channel which knocked off 600bps in sales. In addition, the base quarter last year had a favourable impact of Goods and Services Tax-led re-stocking.

Supply problems: Cipla is currently rebalancing the capacity at some of its facilities in India. This has a short-term top-line impact of around Rs1,000mn per quarter. As these facilities serve products across the product line, it is hard to pinpoint any one particular market being affected.

US business grew 10% QoQ on anticipated lines and the company maintains its guidance of attaining a run-rate of US\$125mn by FY19: Trade receivables have gone up because of many new product launches in the US. Any new product launch can require a company to invest more in receivables. 25% of the business was B2B, but now it has come down to 10%-12%.

South Africa: The private drug market in South Africa grew around 1%-2% on account of appreciation of the South African rand. The government does not allow the immediate pricing in of this impact. But going forward, the pricing appreciation in tender contracts is expected at 3% to 3.5%. The volume is expected to grow 4%-5%.

Exhibit 1: Actual versus our estimate and Bloomberg consensus estimate

(Rsmn)	Actual	NBIE estimate	Var.(%)	Cons. estimate	Var.(%)
Sales	40,075	41,875	(4.3)	41,191	(2.7)
EBITDA	7200	8,243	(14.2)	7,562	(6.4)
EBITDA margin (%)	18	20	(203) bps	18	(70) bps
Reported PAT	3,242	4,548	(28.7)	3,721	(12.9)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Key financials

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Net sales	146,302	152,193	169,992	186,769	203,069
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)	41.3	30.2	24.2	18.9	16.8
P/BV (x)	3.4	3.0	2.7	2.4	2.1
EV/EBITDA (x)	18.7	16.2	12.4	10.1	8.9
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: Quarterly revenue details

Segmental revenues (Rsmn)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
India (Rx+Gx)	13,980	11,940	12,710	16,460	16,010	13,530	15,440	16,440	15,850
North America	6,620	6,460	6,460	6,180	6,500	6,750	6,700	7,580	8,490
South Africa, Sub-Saharan & Cipla global access business	8,200	8,190	7,500	9,210	8,700	8,190	8,310	7,540	7,750
Emerging markets	4,200	4,070	4,630	4,540	3,710	3,940	4,690	4,720	3,930
Europe	1,310	2,030	1,640	1,510	1,710	1,360	1,340	1,410	1,890
API	1,200	1,630	1,300	2,130	1,480	1,350	2,000	1,710	1,540
Others	970	1,500	1,010	800	1,030	1,860	910	720	640
Total	36,480	35,820	35,250	40,830	39,140	36,980	39,390	40,120	40,090
Revenue mix (%)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
India (Rx+Gx)	38.3	33.3	36.1	40.3	40.9	36.6	39.2	41.0	39.5
North America	18.1	18.0	18.3	15.1	16.6	18.3	17.0	18.9	21.2
South Africa, Sub-Saharan & Cipla global access business	22.5	22.9	21.3	22.6	22.2	22.1	21.1	18.8	19.3
Emerging markets	11.5	11.4	13.1	11.1	9.5	10.7	11.9	11.8	9.8
Europe	3.6	5.7	4.7	3.7	4.4	3.7	3.4	3.5	4.7
API	3.3	4.6	3.7	5.2	3.8	3.7	5.1	4.3	3.8
Others	2.7	4.2	2.9	2.0	2.6	5.0	2.3	1.8	1.6
*QoQ growth (%)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
India (Rx+Gx)	(4.8)	(14.6)	6.4	29.5	(2.7)	(15.5)	14.1	6.5	(3.6)
North America	(0.3)	(2.4)	-	(4.3)	5.2	3.8	(0.7)	13.1	12.0
South Africa, Sub-Saharan & Cipla global access business	(6.6)	(0.1)	(8.4)	22.8	(5.5)	(5.9)	1.5	(9.3)	2.8
Emerging markets	2.2	(3.1)	13.8	(1.9)	(18.3)	6.2	19.0	0.6	(16.7)
Europe	(1.5)	55.0	(19.2)	(7.9)	13.2	(20.5)	(1.5)	5.2	34.0
API	4.3	35.8	(20.2)	63.8	(30.5)	(8.8)	48.1	(14.5)	(9.9)
Others	19.8	54.6	(32.7)	(20.8)	28.8	80.6	(51.1)	(20.9)	(11.1)
Total	(2.7)	(1.8)	(1.6)	15.8	(4.1)	(5.5)	6.5	1.9	(0.1)
*YoY growth (%)	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
India (Rx+Gx)	-	-	-	12.0	14.5	13.3	21.5	(0.1)	(1.0)
North America	-	-	-	(6.9)	(1.8)	4.5	3.7	22.7	30.6
South Africa, Sub-Saharan & Cipla global access business	-	-	-	4.9	6.1	-	10.8	(18.1)	(10.9)
Emerging markets	-	-	-	10.5	(11.7)	(3.2)	1.3	4.0	5.9
Europe	-	-	-	13.5	30.5	(33.0)	(18.3)	(6.6)	10.5
API	-	-	-	85.2	23.3	(17.2)	53.8	(19.7)	4.1
Others	-	-	-	(1.2)	6.2	24.0	(9.9)	(10.0)	(37.9)
Total	-	-	-	8.9	7.3	3.2	11.7	(1.7)	2.4

*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 4: Quarterly snapshot

Particulars	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Margin (%)										
Gross profit	64.5	64.3	63.3	66.6	62.0	64.8	64.0	63.9	64.8	63.5
EBITDA	18.1	18.6	14.1	18.3	19.7	20.9	15.1	18.4	18.8	18
PAT	9.4	10.3	(1.8)	11.6	10.7	10.3	4.1	11.3	9.1	8.1

Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 5: Income statement

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Net sales	146,302	152,193	169,992	186,769	203,069
% growth	6	4	12	10	9
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	121,545	123,929	134,629	145,008	157,846
EBITDA	24,758	28,264	35,362	41,761	45,223
% growth	-	14	25	18	8
EBITDA margin (%)	17	19	21	22	22
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	111,345	124,201	135,041
% growth	7	5	14	12	9
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)	43	40	28	13
Tax	1,798	2,501	6,872	8,798	9,900
Effective tax rate (%)	15	14	28	28	28
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)	36	25	28	13
EPS (Rs)	13	18	22	28	32
% growth	(25)	37	25	28	13

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Equity	1,609	1,610	1,610	1,610	1,610
Reserves	123,828	140,682	157,623	179,515	204,241
Net worth	125,437	142,292	159,233	181,125	205,852
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	181,306	194,642	206,177	225,606	248,245
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	108,141	117,757	138,050	163,028
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	121,575
Total assets	181,306	194,642	206,178	225,607	248,246

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Cash flow

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
EBIT	13,816	17,837	25,572	32,345	36,189
(Inc./dec. in working capital)	(414)	(12,473)	6,645	(4,091)	(4,560)
Cash flow from operations	13,401	5,364	32,217	28,253	31,629
Other income	(2,287)	(3,577)	(628)	(1,389)	(2,156)
Other expenses	(2,188)	(1,761)	-	-	-
Depreciation	13,229	13,228	10,418	10,805	11,191
Tax paid (-)	(1,798)	(2,501)	(6,872)	(8,798)	(9,900)
Net cash from operations	20,358	10,754	35,135	28,872	30,764
Capital expenditure (-)	(10,676)	(10,794)	(14,759)	(12,185)	(11,676)
Net cash after capex	9,681	(40)	20,376	16,687	19,087
Other investment activities	(412)	3,692	628	1,389	2,156
Cash from financial activities	(11,742)	(239)	(7,164)	(4,119)	(3,650)
Opening cash balance	8,714	6,242	9,656	23,495	37,453
Closing cash balance	6,242	9,656	23,495	37,453	55,046
Change in cash balance	(2,472)	3,414	13,839	13,957	17,594

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Key ratios

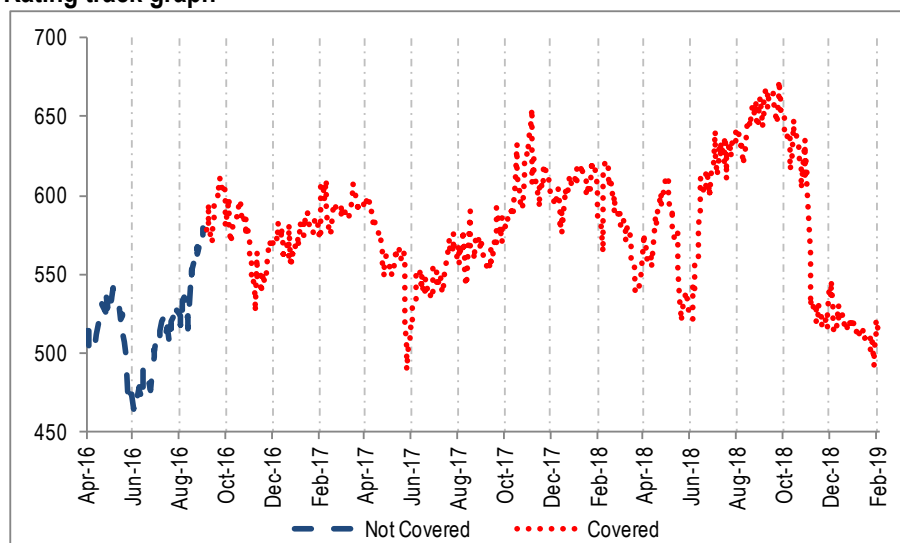
Y/E March	FY17	FY18	FY19E	FY20E	FY21E
Profitability & return ratios					
EBITDA margin (%)	16.9	18.6	20.8	22.4	22.3
EBIT margin (%)	9.4	11.7	15.0	17.3	17.8
Net profit margin (%)	7.1	9.3	10.4	12.1	12.5
RoE (%)	8.3	10.0	11.1	12.5	12.4
RoCE (%)	8.5	10.0	13.5	15.6	15.7
Working capital & liquidity ratios					
Receivables (days)	61	67	70	70	70
Inventory (days)	247	249	258	259	257
Payables (days)	103	122	135	136	135
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)	3.2	3.0	2.6	2.3	2.0
EV/EBITDA (x)	18.7	16.2	12.4	10.1	8.9
P/E (x)	41.3	30.2	24.2	18.9	16.8
P/BV (x)	3.4	3.0	2.7	2.4	2.1

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
7 February 2019	Buy	528	657

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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