

Institutional Equity Research

# Cipla

Pharmaceuticals | India

2QFY19 Result Update | November 06, 2018

CMP* (Rs)	564
Upside/ (Downside) (%)	(6.9)
Bloomberg Ticker	CIPLA IN
Market Cap. (Rs bn)	454
Free Float (%)	63
Shares O/S (mn)	805

**HOLD** 

Target Price: Rs525

## Weak Outlook; Downgrade to HOLD

Cipla has reported lower-than-expected performance in 2QFY19 with its revenue declining by 1.7% YoY (+1.9% QoQ) to Rs40.1bn led by muted to weak sales across geographies (barring the US) owing to high YoY base and challenging environment. Domestic sales remained flat on YoY basis (+6.5% QoQ) to Rs16.4bn due to high YoY base, while the US sales grew by 22.7% YoY (+13.1% QoQ) to Rs7.6bn aided by sales contribution from new products launched in last 12 months. Gross margin expanded by 317bps YoY (+126bps QoQ) to 64.2% due to product rationalisation, cost optimisation and ramp-up in key Direct-to-Market (DTM) launches. However, EBITDA margin contracted by 220bps YoY and 93bps QoQ to 17.5% owing to higher operating expenses and R&D cost. PAT declined by 10.8% YoY (-16.4% QoQ) to Rs3.8bn led by weak operating performance. The Management envisages growth pressure on sales and profitability in 2HFY19 owing to higher raw material prices (supply constraint from China), capacity issues (Rs4bn annual impact; hit on high-margin products) and decline in tender business (lack of funding in malaria and antiretroviral segments). **Considering weak quarterly performance and imminent challenges in 2HFY19E, we downgrade our recommendation on the stock to HOLD from BUY with a revised Target Price of Rs525 (from Rs690 earlier).**

### Conference Call – Key Highlights

- **India Biz (41% of Sales):** The Management maintained earlier guidance of US\$1bn sales for India business in FY19. Led by high base in FY18 and late start of anti-infective season, we expect 10% YoY growth in FY19E and 14% YoY growth in FY20E. Notably, the Company has lost revenues to the tune of ~Rs600-700mn due to late start of anti-infective season.
- **US Biz (19% of Sales):** Overall share of B2B business in overall sales declined to 19% from 26% in Q2FY18. Post receiving 7 approval for ANDAs in 2QFY19 (including Atazanavir, Diclofenac gel and Albendazole), Cipla expects to file >20 ANDAs and launch 15 products in FY19E. Top 3 products i.e. Gabapentin, gPulmicort and Bupropion contributed 15% to its US sales. Recently approved gToprol XL could be 3-4% of US sales opportunity.
- **South Africa Biz (13% of Sales):** Weak sales growth can be attributed to lower tender (40% of SA sales) off-take in Global Access business. As per IQVIA (IMS) MAT Aug-18, SA business grew by 14% (vs. 5% market growth) in private market (non-tender in CC terms).
- **Emerging Markets (12% of sales):** Around 30% of EM business came from tenders. Cipla has been facing currency and business volatility risk in these markets.

### Outlook & Valuation

Cipla is facing challenges in terms of higher input cost led by (led by supply constraint from China), capacity issues (hit on high margin products) and decline in tender business (lack of funding in malaria and antiretroviral), which will restrict overall sales and profitability growth in FY19E and FY20E, in our view. **Reducing revising our sales/earnings estimates by 10.4%/16.2% and 21.7%/27.5% for FY19E/FY20E, respectively, we downgrade our recommendation on the stock to HOLD from BUY with a revised Target Price of Rs525 (from Rs690 earlier).**

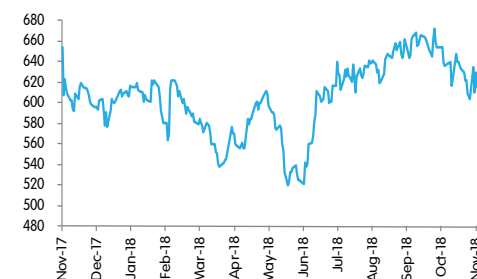
Key Financials (Rs mn)	FY17	FY18	FY19E	FY20E
Sales	146,302	152,193	161,757	176,832
EBITDA	24,758	28,268	29,116	33,846
Adj. PAT	9,103	14,994	15,881	20,130
EPS (Rs)	11.3	18.6	19.7	25.0
P/E (x)	49.8	30.3	28.6	22.6
EV/Sales (x)	3.3	3.2	3.0	2.6
EV/EBITDA (x)	19.7	17.2	16.5	13.8
ROE (%)	7.3	10.5	10.2	11.7
ROCE (%)	8.2	10.1	11.8	13.8

Source: Company, RSec Research

Share price (%)	1 mth	3 mth	12 mth
Absolute performance	(11.1)	(11.5)	(14.0)
Relative to Nifty	(13.1)	(3.9)	(14.7)

Shareholding Pattern (%)	Sep-18	Jun-18
Promoter	36.8	36.8
Public	63.2	63.2

### 1 Year Stock Price Performance



Note: \* CMP as on Nov. 05, 2018

Research Analyst: Krishnanath.Munde

Contact: (022) 33034629

Email: Krishnanath.Munde@relianceada.com

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**Risks to view**

- ▶ Any substantial delay in getting product approvals from the US FDA.
- ▶ Adverse currency movement.

**Exhibit 1: Result Summary**

(Rs mn)	2QFY19	2QFY18	YoY, %	1QFY19	QoQ, %
<b>Net Sales</b>	<b>39,479</b>	<b>39,882</b>	<b>(1.0)</b>	<b>38,458</b>	<b>2.7</b>
Other operating income	640	942	(32.1)	932	(31.3)
<b>Total sales</b>	<b>40,119</b>	<b>40,824</b>	<b>(1.7)</b>	<b>39,390</b>	<b>1.9</b>
Cost of Revenues	14,120	15,531	(9.1)	14,239	(0.8)
Gross Profit	25,359	24,352	4.1	24,219	4.7
% of net sales	64.2%	61.1%	317bps	63.0%	126bps
Employee expenses	7,122	6,608	7.8	7,140	(0.2)
Other Expenses	11,853	10,641	11.4	10,747	10.3
Total operating expenses	33,095	32,780	1.0	32,126	3.0
<b>EBITDA</b>	<b>7,023</b>	<b>8,044</b>	<b>(12.7)</b>	<b>7,264</b>	<b>(3.3)</b>
EBITDA margin (%)	17.5%	19.7%	-220bps	18.4%	-93bps
Depreciation	2,819	3,022	(6.7)	2,410	17.0
<b>EBIT</b>	<b>5,530</b>	<b>6,155</b>	<b>(10.2)</b>	<b>6,555</b>	<b>(15.6)</b>
Other Income	1,326	1,133	17.0	1,701	(22.1)
Interest	444	420	5.6	351	26.4
<b>PBT</b>	<b>5,086</b>	<b>5,735</b>	<b>(11.3)</b>	<b>6,204</b>	<b>(18.0)</b>
Total tax	1,424	1,374	3.6	1,737	(18.0)
Tax Rate (%)	28.0%	24.0%		28.0%	
Minority Interest	109	(135)		46	
<b>Adj PAT</b>	<b>3,772</b>	<b>4,226</b>	<b>(10.8)</b>	<b>4,513</b>	<b>(16.4)</b>
Adj. EPS (Rs)	4.7	5.3	(10.8)	5.6	(16.4)

Source: Company RSec Research

**Exhibit 2: Segment-wise sales performance**

(Rs mn)	2QFY19	2QFY18	YoY, %	1QFY19	QoQ, %
India (Rx + Gx)	16,440	16,460	(0.1)	15,440	6.5
South Africa	5,030	5,170	(2.7)	5,750	(12.5)
US	7,580	6,180	22.7	6,700	13.1
Europe	1,410	1,510	(6.6)	1,340	5.2
Emerging Markets	4,720	4,540	4.0	4,690	0.6
API	1,710	2,120	(19.3)	2,000	(14.5)
Others	720	800	(10.0)	910	(20.9)
<b>Total</b>	<b>40,120</b>	<b>40,830</b>	<b>(1.7)</b>	<b>39,390</b>	<b>1.9</b>
<b>US (US\$ mn)</b>	<b>108</b>	<b>96</b>	<b>12.5</b>	<b>100</b>	<b>8.1</b>

Source: Company RSec Research

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**Profit & Loss Statement**

Y/E March (Rs mn)	FY17	FY18	FY19E	FY20E
<b>Net Sales</b>	<b>146,302</b>	<b>152,193</b>	<b>161,757</b>	<b>176,832</b>
Total Expenditure	121,545	123,925	132,640	142,986
Raw material	53,171	54,380	59,041	63,412
Personnel	26,338	26,901	27,984	30,061
Others	31,345	31,838	33,484	36,251
R&D Expense	10,690	10,806	12,132	13,262
<b>EBITDA</b>	<b>24,758</b>	<b>28,268</b>	<b>29,116</b>	<b>33,846</b>
EBITDA margin	16.9	18.6	18.0	19.1
Depreciation & Amortisation	13,229	13,228	10,781	10,757
EBIT	2,287	3,577	5,500	6,012
Other Income	13,816	18,616	23,835	29,101
Interest & other Charges	1,594	1,142	1,739	1,487
PBT	12,222	17,474	22,096	27,614
Tax	1,798	2,500	6,187	7,456
Tax rate	14.7	14.3	28.0	27.0
MI & Share in profit of Associates	(70)	(28)	(28)	(28)
<b>PAT</b>	<b>9,103</b>	<b>14,994</b>	<b>15,881</b>	<b>20,130</b>
Extraordinary item (EI)	(1,955)	775	-	-
Reported PAT	10,354	14,171	15,881	20,130
<b>Adj EPS (Rs)</b>	<b>11.3</b>	<b>18.6</b>	<b>19.7</b>	<b>25.0</b>

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**Balance Sheet**

Y/E March (Rs mn)	FY17	FY18	FY19E	FY20E
<b>SOURCES OF FUNDS</b>				
Equity Share Capital	1,609	1,610	1,610	1,610
Reserves & Surplus	125,437	142,292	155,095	171,322
Shareholders Funds	125,437	142,292	155,095	171,322
Minority Interest	4,382	3,524	3,552	3,580
Total Loans	41,120	40,979	45,979	38,979
Other long-term financial liab.	1,388	1,434	1,362	1,294
<b>Total Liabilities</b>	<b>172,327</b>	<b>188,229</b>	<b>205,988</b>	<b>215,176</b>
<b>APPLICATION OF FUNDS</b>				
Gross Block	96,200	106,970	113,480	119,525
Less: Acc. Depreciation	18,620	30,930	41,711	52,468
Net Block	77,580	76,040	71,769	67,057
Capital Work-in-Progress	7,192	5,124	5,614	6,069
Goodwill on Consolidation	26,967	28,147	28,147	28,147
Investments	9,748	12,599	15,512	17,063
Current Assets	79,669	97,113	116,149	130,598
Cash	6,239	9,650	20,712	26,267
Loans & Advances	95	199	212	231
Other	73,335	87,264	95,225	104,100
Current liabilities	30,471	35,342	36,523	39,927
Net Current Assets	49,198	61,770	79,626	90,671
Net Deferred Tax	(5,888)	(3,161)	(3,161)	(3,161)
Other non-current assets	7,530	7,710	8,481	9,329
<b>Total Assets</b>	<b>172,327</b>	<b>188,229</b>	<b>205,988</b>	<b>215,176</b>

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**Cash Flow Statement**

Y/E March (Rs mn)	FY17	FY18	FY19E	FY20E
Profit before tax	12,222	16,695	22,096	27,614
Depreciation	13,229	13,228	10,781	10,757
Interest provided	1,594	1,142	1,739	1,487
Change in Working Capital	2,354	(7,833)	(7,636)	(6,407)
Tax Paid	(4,503)	(7,220)	(6,187)	(7,456)
Others	(1,069)	(1,388)	-	-
<b>Cash Flow from Operations</b>	<b>23,827</b>	<b>14,625</b>	<b>20,793</b>	<b>25,995</b>
(Inc.)/ Dec. in Fixed Assets	(11,360)	(8,162)	(7,000)	(6,500)
(Inc.)/ Dec. in Investments	(430)	(367)	(2,913)	(1,551)
Others	(132)	(1)	-	-
<b>Cash Flow from Investing</b>	<b>(13,105)</b>	<b>(8,540)</b>	<b>(9,913)</b>	<b>(8,051)</b>
Issue of Equity	120	1	-	-
Inc./(Dec.) in loans	(10,800)	(350)	5,000	(7,000)
Dividend Paid (Incl. Tax)	(1,936)	(1,893)	(3,079)	(3,903)
Interest provided	(1,594)	(1,178)	(1,739)	(1,487)
<b>Cash Flow from Financing</b>	<b>(13,263)</b>	<b>(3,852)</b>	<b>182</b>	<b>(12,389)</b>
Inc./(Dec.) in Cash	(2,541)	2,233	11,062	5,555
Opening Cash balances	8,582	6,239	9,650	20,712
<b>Closing Cash balances</b>	<b>6,239</b>	<b>9,650</b>	<b>20,712</b>	<b>26,267</b>

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**Key Ratios**

Y/E March	FY17	FY18E	FY19E	FY20E
<b>Valuation Ratio (x)</b>				
P/E	49.8	30.3	28.6	22.6
P/CEPS	20.3	16.1	17.0	14.7
P/BV	3.6	3.2	2.9	2.6
Dividend yield (%)	0.4	0.6	0.7	0.9
EV/Sales	3.3	3.2	3.0	2.6
EV/EBITDA	19.7	17.2	16.5	13.8
<b>Per Share Data (Rs)</b>				
EPS	11.3	18.6	19.7	25.0
Cash EPS	27.8	35.1	33.1	38.4
DPS	2.4	3.6	3.8	4.8
Book Value (BV)	155.9	176.7	192.6	212.8
<b>Returns (%)</b>				
RoCE	8.2	10.1	11.8	13.8
RoE	7.3	10.5	10.2	11.7
<b>Turnover ratios (x)</b>				
Asset Turnover (Gross Block)	1.5	1.4	1.4	1.5
Asset Turnover (Net Block)	1.9	2.0	2.3	2.6
Inventory (days)	87	97	90	90
Receivables (days)	64	74	87	87
Payables (days)	62	66	66	66
Cash conversion cycle (days)	88	105	111	111

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## Rating History

Date	Reco	CMP	TP
10-Aug-18	BUY	621	690
23-May-18	HOLD	534	580
8-Feb-18	HOLD	616	675
8-Nov-17	HOLD	621	620
14-Aug-17	HOLD	570	557
26-May-17	HOLD	491	523
10-Nov-16	BUY	524	620
12-Aug-16	HOLD	517	563

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## Rating Guides

Rating	Expected absolute returns (%) over 12 months
BUY	>10%
HOLD	-5% to 10%
REDUCE	>-5%

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