

BUY

TP: Rs 595 | ▲ 15%

CIPLA

Pharmaceuticals

07 August 2019

Core EBITDA miss; recovery ahead

Q1 was subdued and had multiple moving parts: (1) reduction in India GRx business by Rs 2bn, (2) Rs 1.6bn sales deferral in India Rx + EM market, (3) gSensipar sales worth US\$40mn, and (4) weak ROW commentary. India business is likely to stabilise by Q3, and Rs 1.6bn of deferred sales should be recovered from Q2. Adj. EBITDA for Sensipar missed estimates by 12% but base margins improved QoQ following diffusion in the trade GRx business. We cut FY20/FY21 EPS by 7-8% and revise TP to Rs 595 (vs. Rs 630).

Vivek Kumar

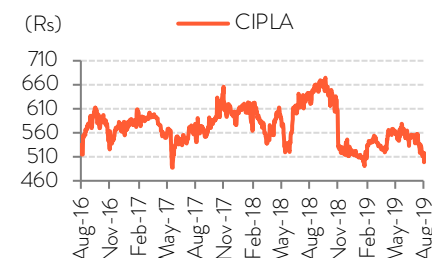
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Weak India, ROW and CGA sales were key negatives leading to EPS cut: India sales declined 12% YoY due to dispatch deferral of Rs 600mn in Rx and GRx destocking of Rs 2bn following a destabilisation risk at old distributors. Recovery is expected from Q3 as ramp-up from new distributors could take time. Cipla's receivable profile has improved QoQ but the lost business cannot be recouped. Deferred sales in ROW plus business challenges in the Middle East & CGA sales are other key negatives. Although part of these sales should be recovered, the annualised impact of subdued sales has led to ~7% earnings cut for FY20/ FY21 and could send the stock into time correction mode for the near term.

Ticker/Price	CIPLA IN/Rs 518
Market cap	US\$ 5.9bn
Shares o/s	806mn
3M ADV	US\$ 14.6mn
52wk high/low	Rs 678/Rs 484
Promoter/FPI/DII	37%/26%/13%

Source: NSE

STOCK PERFORMANCE



Source: NSE

Margins improve sequentially ex-gSensipar: US sales were strong at US\$ 160mn, mainly from gSensipar (US\$ 40mn in our view). US base business should stabilise from Q2 following multiple generic entrants. Ex-Sensipar, we believe base business EBITDA margins/gross margins have improved ~140bps/~400bps QoQ following a drop in low-margin India GRx business.

Call takes: (1) Contribution from trade GRx at 16% in Q1 (23% in FY19); (2) Advair filing on track for FY20-end; (3) expect meaningful launches in US from Q3, (4) South Africa private market growth to normalise from Q2, and (5) China to be meaningful in next 3-5 years with focus on respiratory and oncology.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	12,340	13,409	15,074	16,904	19,646
Adj. EPS (Rs)	15.3	16.6	18.7	21.0	24.4
Adj. EPS growth (%)	(0.2)	8.7	12.4	12.1	16.2
Adj. ROAE (%)	8.9	9.0	9.5	9.8	10.4
Adj. P/E (x)	33.8	31.1	27.7	24.7	21.3
EV/EBITDA (x)	15.7	14.1	13.6	11.9	10.2

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)	Q1FY20E	Var (%)
Net Sales	39,889	39,399	1.2	44,039	(9.4)	42,122	(5.3)
EBITDA	9,047	7,275	24.4	9,611	(5.9)	7,969	13.5
Depreciation	2,680	2,410	-	5,100	-	3,068	-
EBIT	6,367	4,865	30.9	4,511	41.1	4,901	
Interest	521	350	-	447	-	400	-
Other Income	783	850	-	953	-	500	-
PBT	6,629	5,365	23.6	5,017	32.1	5,001	32.6
Less: Taxation	1,922	1,737	-	1,277	-	1,300	-
Less: Minority Interest	(75)	(46)	-	64	-	0	-
Recurring PAT	4,782	3,674	30.2	3,676	30.1	3,701	29.2
Exceptional Items	0	850	-	0	-	0	-
Reported PAT	4,782	4,524	5.7	3,676	30.1	3,701	29.2
Key Ratios (%)							
Gross Margin	70.0	63.9	-	66.3	-	64.5	-
EBITDA Margin	22.7	18.5	-	21.8	-	18.9	-
Tax / PBT	29.0	32.4	-	25.5	-	26.0	-
NPM	12.0	9.3	-	8.3	-	8.8	-
EPS (Rs)	5.9	4.6	-	4.6	-	4.6	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)	Q1FY20E	Var (%)
Formulations	36,450	36,500	(0.1)	41,080	(11.3)	38,922	(6.4)
India	13,550	15,440	(12.2)	15,000	(9.7)	16,675	(18.7)
US	11,190	6,695	67.1	11,430	(2.1)	9,100	23.0
SAGA	6,910	8,340	(17.1)	8,230	(16.0)	7,400	(6.6)
South Africa	5,320	5,780	(8.0)	5,130	3.7	5,000	6.4
Others/Global Access	1,590	2,560	(37.9)	3,100	(48.7)	2,400	(33.8)
Europe	2,010	1,340	50.0	2,360	(14.8)	1,447	38.9
ROW	2,790	4,685	(40.4)	4,060	(31.3)	4,300	(35.1)
APIs	1,820	2,000	(9.0)	1,740	4.6	2,200	(17.3)
Other Op. income	1,600	910	75.8	1,219	31.3	1,000	60.0
Net Sales	39,870	39,410	1.2	44,039	(9.5)	42,122	(5.3)

Source: Company, BOBCAPS Research

Valuation methodology

We like Cipla for its strong India franchise, rich US pipeline and low risk of price erosion in the US market (due to a benign base and low concentration). Operating leverage in the US business will be a key margin driver in the next two years.

Following the core EBITDA miss in Q1FY20 which was essentially driven by sharp contraction in the India trade generics business as well as weak ROW and South Africa tender business, we cut FY20/FY21 EPS estimates by 7-8%. Rolling valuations over to Sep'21, we revise our target price to Rs 595 from Rs 630, based on 13x FY21E EV/EBITDA (26x implied P/E).

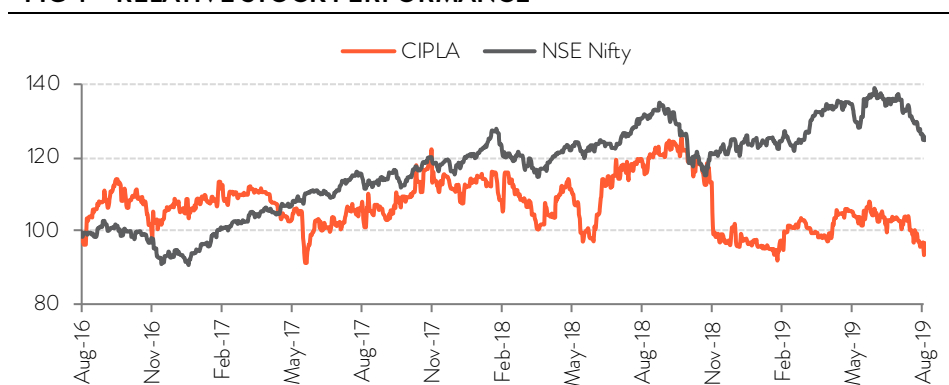
We continue to expect a core EPS CAGR of 18-20% over FY19-FY21. Advair approval represents an upside risk to our EPS estimates. We have valued one-time gSensipar at non-core business multiples. Maintain BUY.

FIG 3 – REVISED ESTIMATES

(Rs bn)	New		Old		Change (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Sales	165	175	177	189	(6.5)	(7.5)
EBITDA	32	34	34	37	(5.1)	(6.2)
EBITDA margin (%)	19.3	19.6	19.0	19.3	29bps	27bps
EPS (Rs)	18.7	21	20.3	23	(7.6)	(7.3)

Source: Company, BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **US execution critical:** We expect the US market to contribute meaningfully to profitability in the coming years. Any delay in key launches (Proventil HFA, Flonase) can potentially erode 4-5% of FY20E/FY21E EPS.
- **Reduction in Global Access funding:** A decline in the tender-facing Global Access business due to challenges in the funding environment poses a risk to our estimates.
- **Above-expected increase in R&D costs:** Should R&D costs increase beyond the current 7-8% of sales, the savings from other cost optimisation measures would be nullified.
- **Weak drug price hikes in South Africa**

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	152,181	163,604	165,116	175,017	188,873
EBITDA	28,254	30,955	31,877	34,338	38,239
EBIT	15,026	17,692	18,518	19,910	22,657
Net interest income/(expenses)	(1,142)	(1,684)	(1,480)	(1,002)	(626)
Other income/(expenses)	984	2,915	3,331	3,934	4,518
Exceptional items	0	0	0	0	0
EBT	14,868	18,924	20,370	22,843	26,549
Income taxes	2,501	5,696	5,296	5,939	6,903
Extraordinary items	1,817	1,850	0	0	0
Min. int./Inc. from associates	27	(181)	0	0	0
Reported net profit	14,157	15,259	15,074	16,904	19,646
Adjustments	1,817	1,850	0	0	0
Adjusted net profit	12,340	13,409	15,074	16,904	19,646

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	21,191	19,480	22,050	23,400	25,283
Other current liabilities	7,904	10,126	9,658	10,249	11,074
Provisions	7,650	8,582	8,650	9,179	9,918
Debt funds	40,980	43,161	30,829	19,268	12,043
Other liabilities	0	0	0	0	0
Equity capital	1,610	1,611	1,611	1,611	1,611
Reserves & surplus	147,378	154,016	166,673	181,159	198,388
Shareholders' fund	148,988	155,627	168,284	182,770	199,999
Total liabilities and equities	226,713	236,976	239,470	244,866	258,317
Cash and cash eq.	9,655	6,188	18,173	24,660	35,519
Accounts receivables	31,020	41,507	33,956	34,163	36,913
Inventories	40,450	39,648	41,894	44,459	48,037
Other current assets	23,697	21,866	22,535	23,914	25,839
Investments	12,586	25,539	25,539	25,539	25,539
Net fixed assets	53,154	51,144	48,717	46,096	43,265
CWIP	9,813	6,762	6,762	6,762	6,762
Intangible assets	46,337	44,322	41,895	39,274	36,443
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	226,712	236,975	239,470	244,866	258,317

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	27,385	28,522	28,433	31,331	35,228
Interest expenses	1,142	1,684	1,480	1,002	626
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(9,765)	(6,412)	6,806	(1,680)	(4,806)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	18,761	23,794	36,718	30,653	31,049
Capital expenditures	(17,369)	(6,228)	(10,932)	(11,807)	(12,751)
Change in investments	(2,856)	(12,953)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(20,225)	(19,181)	(10,932)	(11,807)	(12,751)
Equities issued/Others	1	1	0	0	0
Debt raised/repaid	(146)	2,181	(12,332)	(11,561)	(7,226)
Interest expenses	(1,142)	(1,684)	(1,480)	(1,002)	(626)
Dividends paid	(1,609)	(2,417)	(2,417)	(2,417)	(2,417)
Other financing cash flows	7,775	(6,163)	2,427	2,621	2,831
Cash flow from financing	4,879	(8,082)	(13,802)	(12,359)	(7,438)
Changes in cash and cash eq.	3,415	(3,468)	11,984	6,487	10,859
Closing cash and cash eq.	9,656	6,187	18,172	24,660	35,519

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	17.6	18.9	18.7	21.0	24.4
Adjusted EPS	15.3	16.6	18.7	21.0	24.4
Dividend per share	3.0	3.0	3.0	3.0	3.0
Book value per share	180.8	189.3	205.3	223.4	244.8

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.9	2.7	2.6	2.3	2.1
EV/EBITDA	15.7	14.1	13.6	11.9	10.2
Adjusted P/E	33.8	31.1	27.7	24.7	21.3
P/BV	2.9	2.7	2.5	2.3	2.1

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	83.0	70.9	74.0	74.0	74.0
Interest burden (PBT/EBIT)	98.9	107.0	110.0	114.7	117.2
EBIT margin (EBIT/Revenue)	9.9	10.8	11.2	11.4	12.0
Asset turnover (Revenue/Avg TA)	20.8	21.0	20.7	21.8	22.8
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.3	1.2	1.1
Adjusted ROAE	8.9	9.0	9.5	9.8	10.4

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	4.1	7.5	0.9	6.0	7.9
EBITDA	14.9	9.6	3.0	7.7	11.4
Adjusted EPS	(0.2)	8.7	12.4	12.1	16.2
Profitability & Return ratios (%)					
EBITDA margin	18.6	18.9	19.3	19.6	20.2
EBIT margin	9.9	10.8	11.2	11.4	12.0
Adjusted profit margin	8.1	8.2	9.1	9.7	10.4
Adjusted ROAE	8.9	9.0	9.5	9.8	10.4
ROCE	8.7	10.6	11.0	11.9	13.1
Working capital days (days)					
Receivables	77	95	77	73	73
Inventory	100	91	95	95	95
Payables	52	45	50	50	50
Ratios (x)					
Gross asset turnover	1.2	1.2	1.1	1.1	1.1
Current ratio	2.9	2.9	2.9	3.0	3.2
Net interest coverage ratio	13.2	10.5	12.5	19.9	36.2
Adjusted debt/equity	0.1	0.1	(0.1)	(0.1)	(0.2)

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

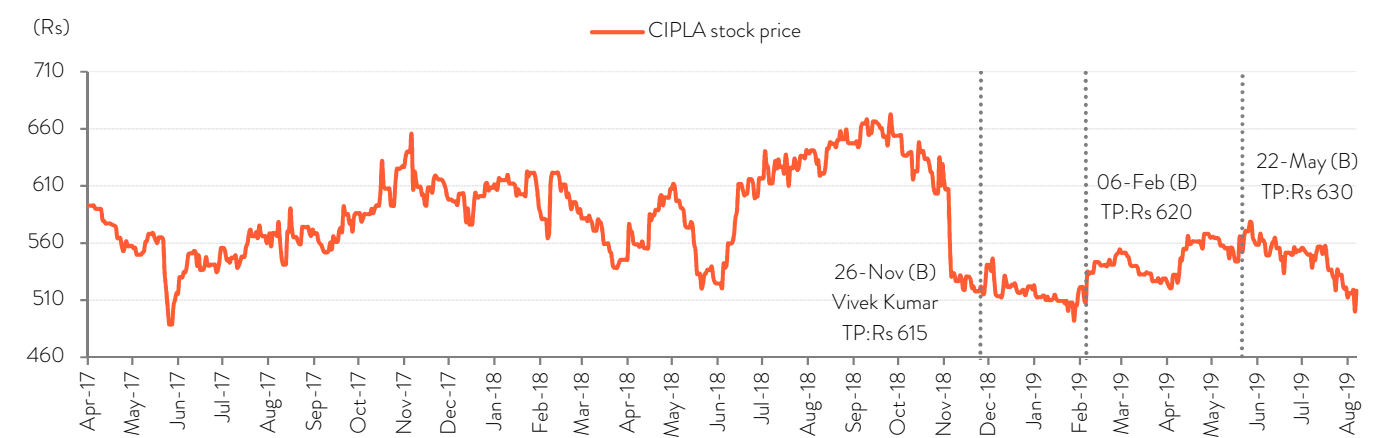
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: CIPLA (CIPLA IN)



B – Buy, A – Add, R – Reduce, S – Sell

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