

BUY

TP: Rs 850 | ▲ 17%

CIPLA

Pharmaceuticals

08 August 2020

Strong Q1 beat; stock catalysts intact – BUY

Cipla reported a Q1 EBITDA beat of 42%/30% on our/consensus estimates, led by (1) Albuterol stocking in the US, (2) chronic/trade generic sales in India, and (3) cost control (-27% YoY), partly non-recurring. EBITDA margin was a solid beat at 24% (22.5% ex-Albuterol) vs. 18% expected. Cost optimisation and improving ROI remain focus areas in coming years. Albuterol ramp-up, Advair filings and a strong branded franchise are stock catalysts. We raise FY21/FY22 EPS by 3% and roll to a new TP of Rs 850 (vs. Rs 690). Retain BUY.

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Broader sales beat: US beat was mainly driven by Albuterol stocking (~US\$ 20mn), barring which the base trend is stable with a marginal dip likely in Q2. India sales grew 19% YoY (Branded +8% YoY, trade generics +46%), partly due to deferred chronic sales. Cipla's focus on consumerisation product trends continues – from trade generics to OTC brands – which should lead momentum. Growth was strong in South Africa private business (+24% YoY, ZAR terms), EU (+19%) and ROW (+64% on low base); API was muted on a high base (one-time tender).

Q1 margins not fully sustainable: Adj. EBITDA margin of 22.5% beat estimates led by (1) lower SGA (-25% QoQ) due to cost optimisation and limited activity amid lockdown (to reverse partly), and (2) lower R&D-to-sales of 4.6% as Advair trial spends are complete (can stay low for next two quarters). Cipla is trying multiple digital formats for conferences/doctor outreach – part of this should aid sustained cost savings. It has broadly guided for 20% margins in FY21.

Earnings call takeaways: (1) Retains ~20-month review timeline for Advair. (2) Albuterol clocked 6% share of weekly prescriptions across brands and is well positioned to respond to new competition; pricing stable. (3) FY21 opex could be at Rs 4bn-5bn, lower vs. earlier budgeted. (4) Goa unit warning letter response submitted. (5) Working on out-licensing for CNS specialty assets.

Ticker/Price	CIPLA IN/Rs 729
Market cap	US\$ 7.8bn
Shares o/s	806mn
3M ADV	US\$ 65.5mn
52wk high/low	Rs 740/Rs 355
Promoter/FPI/DII	37%/26%/13%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20P	FY21E	FY22E	FY23E
Total revenue (Rs mn)	163,621	171,243	178,060	191,896	207,410
EBITDA (Rs mn)	30,973	32,574	35,057	39,001	42,725
Adj. net profit (Rs mn)	13,426	15,858	17,912	20,466	23,314
Adj. EPS (Rs)	16.7	19.7	22.2	25.4	28.9
Adj. EPS growth (%)	8.8	18.1	13.0	14.3	13.9
Adj. ROAE (%)	9.0	10.0	10.3	10.8	11.1
Adj. P/E (x)	43.7	37.0	32.8	28.7	25.2
EV/EBITDA (x)	19.7	18.6	16.9	14.8	13.1

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)	Q1FY21E	Var (%)	FY20	FY19	YoY (%)
Net Sales	43,461	39,889	9.0	43,761	(0.7)	41,953	3.6	171,316	163,622	4.7
EBITDA	10,490	9,047	16.0	6,336	65.6	7,402	41.7	32,563	30,980	5.1
Depreciation	2,689	2,680	-	3,459	-	2,680	-	11,746	13,260	-
EBIT	7,801	6,367	22.5	2,877	171.2	4,722	-	20,817	17,720	-
Interest	460	521	-	530	-	521	-	1,972	1,682	-
Other Income	654	783	-	931	-	783	-	3,440	3,913	-
PBT	7,995	6,629	20.6	3,278	143.9	4,984	60.4	22,285	19,951	11.7
Less: Taxation	2,277	1,922	-	855	-	1,922	-	6,310	5,693	-
Less: Minority Interest	(64)	(75)	-	(36)	-	(75)	-	5	(190)	-
Recurring PAT	5,782	4,782	20.9	2,459	135.1	3,137	84.3	15,970	14,448	10.5
Exceptional Items	0	0	-	0	-	0	-	0	850	-
Reported PAT	5,782	4,782	20.9	2,459	135.1	3,137	84.3	15,970	15,298	4.4
Key Ratios (%)										
Gross Margin	63.4	70.0	-	61.4	-	64.0	-	65.3	64.6	-
EBITDA Margin	24.1	22.7	-	14.5	-	17.6	-	19.0	18.9	-
Tax / PBT	28.5	29.0	-	26.1	-	38.6	-	28.3	28.5	-
NPM	13.3	12.0	-	5.6	-	7.5	-	9.3	8.8	-
EPS (Rs)	7.2	5.9	-	3.1	-	3.9	-	19.9	18.0	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)	Q1FY21E	Var (%)	FY20	FY19	YoY (%)
Formulations	40,890	36,450	12.2	40,580	0.8	38,788	5.4	158,490	153,180	3.5
India	16,080	13,550	18.7	17,300	(7.1)	16,796	(4.3)	66,070	62,730	5.3
US	10,210	11,190	(8.8)	8,560	19.3	9,250	10.4	38,740	34,195	13.3
SAGA	7,630	6,910	10.4	8,250	(7.5)	6,842	11.5	30,870	31,860	(3.1)
South Africa	5,480	5,320	3.0	5,320	3.0	5,067	8.2	22,040	21,510	2.5
Others/Global Access	2,150	1,590	35.2	2,930	(26.6)	1,775	21.1	8,830	10,350	(14.7)
Europe	2,400	2,010	19.4	2,320	3.4	2,000	20.0	8,130	7,000	16.1
ROW	4,570	2,790	63.8	4,150	10.1	3,900	17.2	14,680	17,395	(15.6)
APIs	1,840	1,820	1.1	2,470	(25.5)	1,966	(6.4)	7,510	6,990	7.4
Other Op. income	731	1,600	(54.3)	711	2.8	1,200	(39.1)	5,301	3,408	55.5
Net Sales	43,461	39,870	9.0	43,761	(0.7)	41,953	3.6	171,301	163,578	4.7

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 (top 3 products form 25% of US sales). Operating leverage in the US business will be a key margin driver in the next two years. We believe Cipla’s future investments will have a sharper focus on opportunities in high-value/complex assets, but not at the expense of current margins.

We increase our FY21-FY22 EPS estimates by 3% each and continue to expect a core EPS CAGR of 15-18% over FY20-FY22. Advair approval represents an upside risk to our EPS estimates. We retain BUY and raise our Sep’21 target price to Rs 850 (from Rs 690) based on a revised 16x EV/EBITDA multiple (14x earlier) and rollover of valuations to Sep’22 – this represents an implied P/E of 31x (30x earlier). Our target valuation multiple is at the midpoint of the eight-year historical band (11-21x) and 15% higher than frontline stocks (Sun Pharma, Lupin, Dr Reddy’s) due to Cipla’s higher share of branded products in EBITDA (>70%).

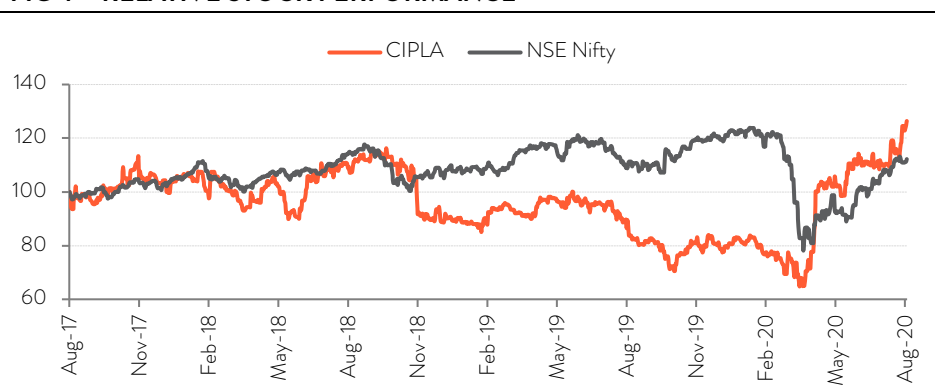
We see scope for further stock rerating on the back of (1) margin upside potential accruing from higher operating leverage as the ‘One India’ strategy gains momentum and cost optimisation remains in focus, and (2) ROIC closing in on peak levels of 20% in the next two years. The global generic environment, especially in the US, remains supportive.

FIG 3 – REVISED ESTIMATES

(Rs bn)	New		Old		Change (%)	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Sales	178	192	178	192	0.0	0.0
EBITDA	35	39	34	38	1.9	1.9
EBITDA margin (%)	19.7	20.3	19.3	19.9	38bps	38bps
EPS (Rs)	22	25	21.6	25	2.8	2.9

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 the ramp up of key launches like Proventil HFA and Flonase launch can potentially erode 4-5% of 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.
- **Weak drug price hikes in South Africa**

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20P	FY21E	FY22E	FY23E
Total revenue	163,621	171,243	178,060	191,896	207,410
EBITDA	30,973	32,574	35,057	39,001	42,725
Depreciation	13,263	11,760	12,893	13,924	15,038
EBIT	17,710	20,814	22,164	25,077	27,687
Net interest income/(expenses)	(1,684)	(1,972)	(1,144)	(715)	(447)
Other income/(expenses)	2,915	3,331	3,517	3,673	4,697
Exceptional items	0	0	0	0	0
EBT	18,941	22,173	24,537	28,035	31,937
Income taxes	5,696	6,310	6,625	7,570	8,623
Extraordinary items	1,850	0	0	0	0
Min. int./Inc. from associates	(181)	5	0	0	0
Reported net profit	15,277	15,858	17,912	20,466	23,314
Adjustments	1,850	0	0	0	0
Adjusted net profit	13,426	15,858	17,912	20,466	23,314

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20P	FY21E	FY22E	FY23E
Accounts payables	19,480	25,013	24,677	26,632	28,824
Other current liabilities	10,126	9,960	10,393	11,216	12,139
Provisions	8,582	8,919	9,307	10,045	10,871
Debt funds	43,161	28,160	17,600	11,000	6,875
Other liabilities	0	0	0	0	0
Equity capital	1,611	1,613	1,613	1,613	1,613
Reserves & surplus	154,016	167,461	182,954	201,001	221,896
Shareholders' fund	155,627	169,073	184,567	202,614	223,509
Total liabilities and equities	236,976	241,125	246,544	261,507	282,218
Cash and cash eq.	6,188	9,630	15,276	26,645	40,572
Accounts receivables	41,507	38,910	37,965	38,412	41,573
Inventories	39,648	43,204	45,083	48,655	52,659
Other current assets	21,866	23,239	24,250	26,171	28,325
Investments	25,539	25,539	25,539	25,539	25,539
Net fixed assets	51,144	48,053	46,967	45,794	44,527
CWIP	6,762	8,245	8,245	8,245	8,245
Intangible assets	44,322	44,305	43,219	42,046	40,779
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	236,976	241,125	246,544	261,507	282,218

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20P	FY21E	FY22E	FY23E
Net income + Depreciation	28,540	27,618	30,805	34,390	38,352
Interest expenses	1,684	1,972	1,144	715	447
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(6,412)	3,373	(1,459)	(2,424)	(5,378)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	23,812	32,963	30,490	32,681	33,421
Capital expenditures	(6,228)	(10,932)	(11,807)	(12,751)	(13,771)
Change in investments	(12,953)	0	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(19,181)	(10,932)	(11,807)	(12,751)	(13,771)
Equities issued/Others	1	1	0	0	0
Debt raised/repaid	2,181	(15,001)	(10,560)	(6,600)	(4,125)
Interest expenses	(1,684)	(1,972)	(1,144)	(715)	(447)
Dividends paid	(2,417)	(2,419)	(2,419)	(2,419)	(2,419)
Other financing cash flows	(6,181)	801	1,086	1,173	1,267
Cash flow from financing	(8,099)	(18,590)	(13,037)	(8,561)	(5,724)
Changes in cash and cash eq.	(3,468)	3,441	5,647	11,369	13,927
Closing cash and cash eq.	6,187	9,629	15,276	26,645	40,572

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20P	FY21E	FY22E	FY23E
Reported EPS	19.0	19.7	22.2	25.4	28.9
Adjusted EPS	16.7	19.7	22.2	25.4	28.9
Dividend per share	3.0	3.0	3.0	3.0	3.0
Book value per share	188.9	205.6	224.8	247.2	273.1

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20P	FY21E	FY22E	FY23E
EV/Sales	3.7	3.5	3.3	3.0	2.7
EV/EBITDA	19.7	18.6	16.9	14.8	13.1
Adjusted P/E	43.7	37.0	32.8	28.7	25.2
P/BV	3.9	3.5	3.2	2.9	2.7

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20P	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	70.9	71.5	73.0	73.0	73.0
Interest burden (PBT/EBIT)	107.0	106.5	110.7	111.8	115.3
EBIT margin (EBIT/Revenue)	10.8	12.2	12.4	13.1	13.3
Asset turnover (Revenue/Avg TA)	21.0	21.6	22.3	23.1	23.4
Leverage (Avg TA/Avg Equity)	1.3	1.2	1.2	1.1	1.1
Adjusted ROAE	9.0	10.0	10.3	10.8	11.1

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20P	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	7.5	4.7	4.0	7.8	8.1
EBITDA	9.6	5.2	7.6	11.3	9.5
Adjusted EPS	8.8	18.1	13.0	14.3	13.9
Profitability & Return ratios (%)					
EBITDA margin	18.9	19.0	19.7	20.3	20.6
EBIT margin	10.8	12.2	12.4	13.1	13.3
Adjusted profit margin	8.2	9.3	10.1	10.7	11.2
Adjusted ROAE	9.0	10.0	10.3	10.8	11.1
ROCE	10.6	12.2	12.9	13.8	14.6
Working capital days (days)					
Receivables	95	86	80	75	75
Inventory	91	95	95	95	95
Payables	45	55	52	52	52
Ratios (x)					
Gross asset turnover	1.2	1.2	1.1	1.1	1.1
Current ratio	2.9	2.6	2.8	2.9	3.1
Net interest coverage ratio	10.5	10.6	19.4	35.1	62.0
Adjusted debt/equity	0.1	0.0	(0.1)	(0.2)	(0.2)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

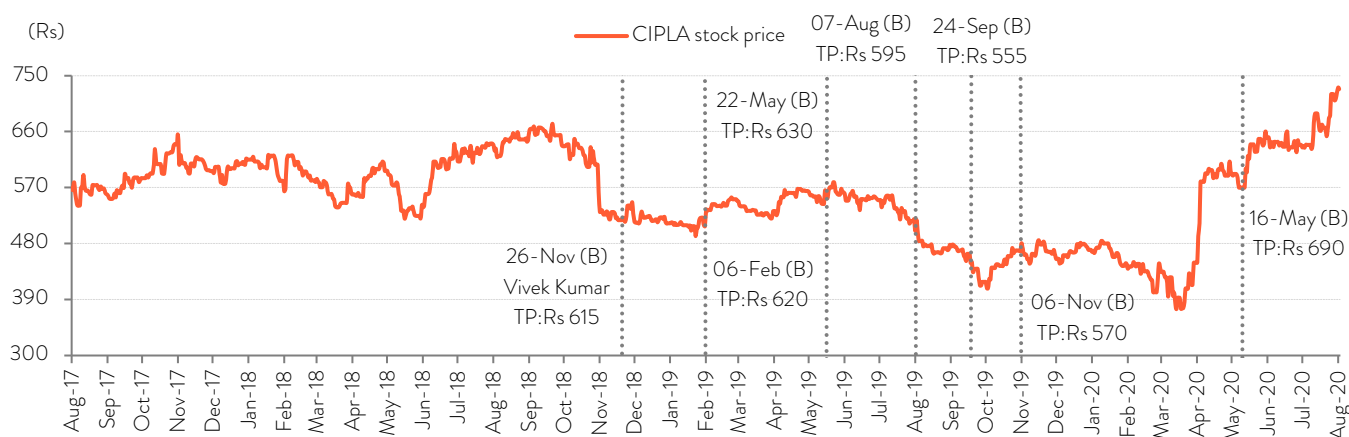
ADD – Expected return from >+5% to +15%

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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